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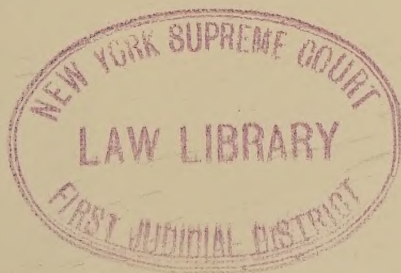
# THE WORK OF THE STOCK EXCHANGE

By

J. EDWARD MEEKER, M.A.

ECONOMIST TO NEW YORK STOCK EXCHANGE

REVISED EDITION



THE RONALD PRESS COMPANY  
NEW YORK

THE WORK  
OF THE  
STOCK EXCHANGE

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## PREFACE

This book was originally published in March, 1922. Until the present time, its text has not been revised except in a few minor details.

In the New York Stock Exchange, these intervening years have been extraordinary, not only in respect to the tremendous increase in the scope and activity of the securities market, but also in respect to qualitative and frequently novel changes in its methods of administration. Rarely if ever before in the long annals of the Exchange have so few years produced so wide-spread a transformation. In consequence, the revision of this book has had to be extensive in proportion.

The events of the past few years have thus been such as to render a revision of this study increasingly desirable, and at the same time very effectually to prevent the author from accomplishing it. For, apart from the pressure of other duties, the process of evolution and change occurring within the Exchange has proved too swift and incessant to permit a fresh description of its activities to possess an even relatively adequate finality.

Just as the original text of this book was written in the dull financial period which followed the crash of 1920, so this revision has been prepared in the doldrums subsequent to the panic of 1929. While this has occurred more by accident than design, there is a real advantage in it. Photography is so much easier when the subject sits still. Nevertheless, the growth and development of the Stock Exchange still imposes a difficult problem on the author. Too many novel administrative undertakings, and too significant an economic evolution still lie ahead of America's premier capital market to render prophecy in this revised edition much easier than in its predecessor. The author has, however, consistently endeavored to indicate such future

direction as the continuing evolution of the Exchange seems at this time likely to take. Subsequent annual reports of its President may be depended upon to chronicle such future Stock Exchange developments as cannot now be clearly foreseen.

The past decade will undoubtedly be characterized, in the economic history of America, as the first peace-time period when the United States began to function as a creditor nation. This development, of such momentous consequence to our entire economic and social status as a nation, has inevitably made itself felt with particular force in our leading capital market on the New York Stock Exchange. Largely in order that this old American business institution might be re-interpreted in the light of the new and significant rôle which it has thus been called upon to play, the present edition of this study has been prepared.

J. EDWARD MEEKER.

New York,

October 1, 1930.



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**THE WORK  
OF THE  
STOCK EXCHANGE**





## CHAPTER I

### THE EVOLUTION OF SECURITIES

**The Two Main Sources of Securities.**—The many indispensable services performed for American business and society by the New York Stock Exchange cannot be adequately explained until the real nature of the securities which find their market on its floor is first understood.

Securities, in the Stock Exchange meaning of the term, may be broadly classified as either governmental or corporate, according to whether they are created by public and political, or private business organizations. In consequence, a brief preliminary sketch is called for here of the development of government financing on the one hand, and of the origin and present economic significance of the modern stock corporation on the other. Inasmuch as political stability has always been a necessary prerequisite to the higher organization and expression of business enterprise, it is only natural that as a rule the extensive issue of government securities should have occurred the earlier in point of historical evolution. To this topic of governmental financing by means of security issues, then, we should first give our attention.

**Need of Government Financing.**—The administrators of governmental organizations, which in most instances are not designed to be run for a profit, must in the absence of earnings necessarily look to the levying of taxes upon the governed as their normal source of financial support.

From the financial and economic standpoint the ideal and perfect government—which has never yet in human history been actually realized, and probably never will be—would be one whose income from taxation exactly equaled its expendi-

tures. Constant attempts have been made to attain this ideal through budget systems and the like, and on certain rare occasions an approximate equilibrium between income and expense has temporarily been achieved. But, at least in the hazardous world of today, only a relative success in exactly balancing the government's books without a remaining surplus or debt seems practically possible; for both the expenses and the revenues of modern government are necessarily variables. Wars in particular may quite unexpectedly make necessary vast increases in governmental expenditure, while the actual sums to be realized through the various kinds of taxation in turn depend upon the veering course of economic development, business prosperity, and other uncertain factors. In the absence, then, of an ability consistently to pay the current expenses of government out of its current taxation revenue, methods have naturally had to be devised for financing the sudden financial needs of government in excess of the amount of its current income.

**Financing with the Printing Press.**—One age-old fallacy looking to this end—the printing of large quantities of irredeemable paper money—deserves passing comment here. To those innocently or wilfully ignorant of the intricate and delicate mechanism of modern currency, such an inflation of the money system may seem a simple and obvious panacea. Their line of reasoning runs somewhat as follows: "The government needs money—money is produced by the printing press—therefore we should print what we need." While this is not the place to inquire into the complexities of modern currency sufficiently to explode this superficial but tremendously dangerous economic fallacy, it is enough to state that every government which has followed this primrose path of financing has in the end discovered it to be not only a highly dangerous but a completely futile expedient. Never in history was the disruptive effect of fiat money on the whole economic structure of civilization illustrated on so extensive a scale, with such

tragic human consequences, and with such an unavoidable economic moral, as in the period following the Great War.

The truth is that there is no royal road to financing governments, simply because they are governments. No practical magic is available which will permit government officials to escape the same invariable economic laws that the individual constantly encounters in his check book. As with individuals, governments which cannot obtain enough current revenue to pay current expenses, must contract debts whose reduction can be effected only by a more favorable ratio between revenues and expenses in the future.

**Early Methods of Government Borrowing.**—The exact methods employed by governments in borrowing money, along with the methods for business borrowing, have, of course, undergone great changes in the past three centuries. Originally, when most European countries were monarchies, and before national debts managed by parliaments and assemblies had been instituted, governmental loans were personally obtained and assumed by the sovereign.<sup>1</sup> Thus, in the sixteenth and seventeenth centuries, and in some countries even later, the kings and queens of Europe constantly resorted to private money-lenders for short-term loans, which afterward were paid off by royal taxation, refunded, or repudiated. Such loans were frequently made on the pledged collateral of the royal jewels, or even on the assignment of specified taxes. The great but troublous reign of Elizabeth was financed through loans made by the Antwerp money-lenders. Such transactions afford strong contrast with governmental financing as we know it today. The risks in such loans were large, for the proverbial honor of princes seemed only occasionally to extend to their debts. Interest rates had to be high enough to insure against the risk of royal repudiation. The element of patriotism in such loans was practically non-existent, nor was there yet any employment of them to promote international trade. More-

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<sup>1</sup> See Appendix Ia.

over, the sums borrowed in this way were comparatively small, and could be made only for short periods, owing to the limited resources of private money-lenders.

**The Increasing Expensiveness of Government.**—However crude dependence of governmental finance upon personal borrowing by the sovereign may seem today, it sufficed fairly well for the relatively small needs of sixteenth and seventeenth century governments. In those distant periods populations were smaller than at present, the standard of living was almost inconceivably lower, and the contemporary warfare with blunderbusses, swords, and sailing ships vastly cheaper. Many a modern city requires vastly more financial accommodation than did the whole kingdom of Elizabeth. Nevertheless, the expenses of government were through this period steadily increasing, owing to such diverse factors as the Spanish discoveries of gold in America, the frequent and expensive amours of a Charles or a Louis, and the semireligious, semipolitical wars in the low countries and elsewhere. Financial stringency helped to expel the last Stuart king from England in 1688, and to dampen the warlike ardor of his successor, William III.

During the reign of the latter, however, a financial policy was adopted with profound consequences for society. Interest-bearing negotiable certificates acknowledging the public indebtedness were issued by the State, and sold to the recently created class of English investors who were earnestly seeking a safe way of investing their savings. In contrast to the private money-lending institutions of the day, such investors possessed a vastly larger aggregate of investable funds, and in addition they generally preferred to make long-term rather than short-term loans—so much so, in fact, that the principal portion of both the British and French funded national debts came subsequently to be issued in securities without a maturity date.

**Modern Government Expenditure.**—Since about 1700, when this new and practical means of obtaining larger funds



for government use by the sale of interest-bearing government certificates of indebtedness to private investors began, the expenditures of governments have continually grown. The increased economic complexity of civilization has necessitated a vast extension of the functions of government even in times of peace. Today the U. S. Government, besides protecting Americans against external invasion or domestic violence, distributes the mail, builds roads, inspects food products, conserves natural resources, carries on scientific research in behalf of American agriculture, commerce, and industry, and performs for its citizens thousands of other distinct and costly services which were often undreamt of a century ago. In this expansion of its functions our government has been typical of other modern and progressive governments throughout the world.

But a still more significant need for governmental borrowing has arisen from the vastly increased cost of warfare. In the terrible conflicts of modern times, not merely specialized fighting men but entire populations have had to be mobilized at an appalling expense. Although only about a quarter as long in duration as the Napoleonic Wars, the Great War proved in the case of England, roughly, ten times as expensive.<sup>2</sup> It is chiefly owing to the tremendous cost of modern scientific methods of warfare that every great government in the world today carries an unprecedented burden of debt, and that so many important stock exchanges in the world experience large daily volumes of purchases and sales of government securities.

Not only national governments but also their various subdivisions have likewise become accustomed to finance their needs through the issuance of securities. In this country, for example, our investors hold, in addition to the bonds of our national government, the interest-bearing obligations of our states, counties, and municipalities. In most respects these

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<sup>2</sup> See Appendix Ib.

bonds of political subdivisions resemble national government bonds in their basic characteristics.

**Government Securities.**—While sufficient space is lacking here for any adequate exposition of the technical features of government securities, nevertheless a few essential points may briefly be enumerated. There is considerable difference among present-day government securities as to the coin in which they are repayable. While in most cases the coin of the issuing nation is specified, with some "external loans" the standard coin of some other nation where the bonds have been mainly sold may be designated. Some government securities which have had an international distribution provide for repayment in the coin of any one of several different countries. Also the practice in respect to the redemption or maturity date varies widely—contrasting with some temporary government obligations extending only a few months, are the classic British Consols or French *rentes* which, having no specified maturity date, are in theory irredeemable. Some government securities possess sinking fund provisions whereby a certain sum must be periodically set aside for retiring and paying off the issue at its maturity.

Almost all government securities, however, are fundamentally based upon taxation, and their value must therefore depend upon the honor and prospective financial future of their respective governmental organizations. In the abstract, the obligation of a government, whether a nation or only a city, may constitute a claim against all the wealth of its inhabitants, but practically no way is provided for the holder of a government bond in default to attempt to enforce any such claim.

**Evolution of the Stock Corporation.**—We now come to the other type of security-creating organization—the private business stock corporation. As in the case of governments, something of the historical background of the stock corporation must be known before its present-day economic signifi-

cance can be adequately grasped. Simple business partnerships, in which two or more men engage in an enterprise together, provide its capital, assume its debts, and divide its profits, are older than the Pyramids. But the great stock corporation of today, although its roots may extend back into history as far or even further than the *collegium* of the Romans, is nevertheless a comparatively new form of business organization. Nothing, in fact, more clearly indicates how very swiftly commerce, industry, and transportation have expanded during the past half-century than the recent dates at which so many of our greatest modern corporations have been organized. Indeed, many men who have yet to attain old age have lived through that whole marvelous economic period in American history which our historians are already calling "the age of big business."

With the constantly increasing amount of goods produced, transported, and consumed, there has been an inevitable corresponding increase in the size and capitalization of the business organizations which conduct this production and distribution. Profound economic forces in the modern world have for over a century been constantly calling for larger and larger operating units in almost all lines of business. Experience has clearly shown that in most cases a large business enterprise can be more advantageously conducted as a corporation than as a partnership.

**America's Debt to Corporations.**—It is peculiarly fitting that the fullest and most rapid development of the stock corporation as a mechanism for carrying on the "big business" of the modern world should have occurred in the United States. The stock corporation has entered more deeply into our history than into that of any other modern nation. From its earliest history North America has been explored by corporations, colonized by corporations, and developed by corporations. To be sure, Raleigh, Gilbert, and those other daring British searovers who first attempted to establish colonies on our Atlantic

seaboard, were financed through partnerships formed by a few wealthy London noblemen; but their repeated failures proved that a few men of wealth could not easily raise sufficient funds to insure the success of such colonizing enterprises.

Accordingly, the British effort to settle this continent was taken up in the early seventeenth century by crude joint-stock companies, whose organization made it possible to attract more partners into these colonizing attempts and by so doing give them a larger financial backing. As a result, the first permanent European settlement in this country at Jamestown in 1607, was established by the London Company. Financially speaking, the Pilgrim fathers were holders of labor-shares in a subsidiary of the Plymouth Company, chartered in 1620. The expenses of the initial venture which resulted in our present New England states were borne by the stockholders of this corporation. One share was allotted to each of the Pilgrims and additional shares were sold to them for £10 apiece, so that even in the beginning some of its stock was held in America. Not all New Yorkers remember that it was from an employee of another ancient corporation, the Dutch East India Company, that the majestic Hudson River derived its name. Indeed, the venerable Hudson's Bay Company (or, to use its quaint legal title, "The Governor and Company of Adventurers of England trading into Hudson's Bay"), which was organized in 1670 and named after the same intrepid explorer, still exists after having played a huge part in the economic development of modern Canada.

**Early British Companies.**—During the seventeenth and eighteenth centuries, however, the control of these early corporation settlements in what is now the United States was soon taken over by the settlers themselves. These early British companies differed in important respects from the modern corporations of which they were the forerunners. Their shares were, of course, intensely speculative and, since stock markets were



not as yet highly organized, were neither easily salable nor readily available to the average Englishman as investments.

Compared with our own times the business world of the seventeenth and eighteenth centuries was poor, slow-moving, risky, wasteful, and inefficient. Steam power had not yet been harnessed to industry and transportation, and large business organizations as we know them today were, if only for this reason, still impossible. The manufacturer of 1700 could produce his wares only by hand and in small quantities—consequently he made little effort to concentrate his manufacturing under a single factory roof, but let it out piecemeal to his employees to be performed in their cottages. From this last fact the term “cottage industry” is used to designate the manufacturing enterprises of this period.

**Seventeenth Century Transportation.**—But even if such an inefficient system had permitted the manufacturer to produce large quantities of goods they could not have been distributed quickly, securely, or in considerable amounts by the clumsy stage coaches and canals of that period. Macaulay has drawn a graphic picture of English transportation conditions<sup>3</sup> in the latter decades of the seventeenth century:

There were no railways, except a few made of timber from the mouths of the Northumbrian coal pits to the banks of the Tyne. There was very little internal communication by water. A few attempts had been made to deepen and embank the natural streams, but with slender success. Hardly a single navigable canal had been even projected.

It was by the highways that both travellers and goods generally passed from place to place . . . on the best lines of communication the ruts were deep, the descents precipitous, and the way often such as it was hardly possible to distinguish, in the dusk, from the unenclosed heath and fen which lay on both sides. . . . It was only in fine weather that the whole breadth of the road was available for wheeled vehicles. Often the mud lay deep on the right and the left, and only a narrow track of firm ground rose above the quagmire. . . . It happened almost every day, that coaches stuck fast, until a team of cattle

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<sup>3</sup> Macaulay, “History of England,” Ch. III.



could be procured from some neighboring farm to tug them out of the slough. . . .

The markets were often inaccessible during several months. It is said that the fruits of the earth were sometimes suffered to rot in one place, while in another place, distant only a few miles, the supply fell far short of the demand. . . . On the best highways, heavy articles were, in the time of Charles the Second, generally conveyed from place to place by stage wagons. . . . The expense of transmitting heavy goods in this way was enormous. From London to Birmingham the charge was seven pounds a ton; from London to Exeter twelve pounds a ton. This was about fifteen pence a ton for every mile . . . fifteen times what is now demanded by railway companies. The cost of conveyance amounted to a prohibitory tax on many useful articles. Coal in particular was never seen except in the districts where it was produced, or in the districts to which it could be carried by sea, and was indeed always known in the south of England by the name of sea coal.

What transportation was like in newly settled America, when the above conditions prevailed in the world's leading commercial nation, can best be left to the imagination.

Moreover, owing mainly to these primitive methods of producing and distributing goods, the buying or consumptive powers of the people were then exceedingly limited. Poverty was much more widespread than today, and not only were existing populations only a fraction of what they now are, but the per capita buying power was likewise very much lower. Neither had organized markets nor other parts of the modern machinery of credit yet been created. In consequence of these temporarily insuperable difficulties, the eighteenth century was in the main a period of small business enterprises, which could be organized satisfactorily enough as partnerships, with, of course, no stocks or bonds to sell to the public.

**The Rise of Large-Scale Industry.**—Capitalism in Europe found its earliest free expression and significant development in commerce rather than industry. Only in wholesale commercial operations with as a rule distant lands, did the opportunity for large profits, or the need for large capital, exist. Accordingly, the first important stock corporations in Europe

were exploration and commercial development companies like the Dutch East India Company, the French *Compagnie des Indes Occidentales*, or the British East India, and many similar companies. Many of these old British exploration companies still exist, and still perform important economic functions in the development of North America, Africa, and elsewhere.

But in the late eighteenth century the practical development of machinery, and particularly the application of water and then steam power to industrial purposes, made large industrial profits possible, and called for large sums of capital to purchase and maintain extensive industrial equipment. Thus it was principally the invention of the steam engine and its practical employment in steam railways and steam factories that at the opening of the nineteenth century wrought a profound and permanent change in business methods and business organization. Indeed, the so-called Industrial Revolution which resulted was ultimately destined to raise standards of living, increase populations, modify laws, overthrow governments, upset almost immemorial business practices, transform finance and the stock exchanges, shift the routes of trade, create and destroy market places, and alter profoundly the morals, beliefs, and the very security of many nations.

The Industrial Revolution, however, at once encountered serious obstacles arising from the very structure of the small-scale business of that day. Unconsciously, industrial enterprises had grown beyond the point where a few wealthy partners could finance them. Thus the larger enterprises which steam locomotives and steam factories necessitated could not be financed until the stock corporation was developed to enable more partners to engage in them, and until stock exchanges were developed to stabilize and protect investment by the public in the new corporate bonds and shares.<sup>4</sup>

**Financing the First Railroads.**—A significant example of just how difficult it was for individuals to finance the great

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<sup>4</sup> Appendix Ic.

American business enterprises launched in the first decades of the nineteenth century is furnished by the early development of the steam locomotive. That this machine could successfully pull unheard of loads over rails at an unprecedented speed was demonstrated beyond the peradventure of a doubt. The public, too, had sufficient imagination to realize the new era in the history of transportation which was promised. But for all that, the locomotive was for some time considered only an impracticable inventor's dream. No American, nor partnership of Americans, it was publicly argued, was rich enough to finance the building of a railroad—therefore railroads could never be built. This hasty syllogism was not exploded until the organization of some of our great railroad stock corporations revealed its fallacy. Not until the savings of thousands of individuals were successfully enlisted in railroad enterprises by the creation of a large stock corporation, did steam railroad transportation emerge from the inventor's shed to become the indispensable carrier upon which modern industry and much of modern social life has since been builded.

Nor was the ability to handle a larger volume of business with a greater equipment the only advantage gained for the more secure and successful conduct of business by the development of the modern stock corporation. Many important advantages resulted to the benefit of the shareholder as an investor. For one thing, the corporation became a deathless entity whose affairs would not have to be liquidated or reorganized whenever a partner died. It furthermore permitted a greater concentration of control in its management, which likewise made for greater safety and efficiency. It could attract capital in amounts varying from the small investor's mite to the fortunes of the wealthy, and also made it easier for anyone to invest in a business without the need of directly sharing in its management as well. In addition, since almost all stocks in time became non-assessable, the investing shareholder was freed from personal liability for the losses of the corporation.

**The Stock Exchange and Corporate Development.**—In the distribution of corporate securities among American investors during the past century the New York Stock Exchange has played and is today playing a necessary part. Exactly how the constant market for securities maintained by the Exchange operates today to assist corporations in obtaining funds and the public to obtain the best investments at the fairest prices, will be related in subsequent chapters.<sup>5</sup> It is sufficient at present to point out that the Stock Exchange has been a vital factor in helping our railroad corporations to secure the funds which made it possible for them to span our great continent with their myriad tunnels and bridges and their thousands of miles of steel-shod roadways.

Still more recently our gigantic industrial enterprises have been enabled through the assistance of the Stock Exchange to build those vast mills and factories which the whole world trend of modern production has necessitated. Without the creation of these huge companies and the safeguarding of their stockholders through the daily operations of the New York Stock Exchange, the marvelously swift development of American transportation and industry would have been quite impossible.

**Growth of the "Trusts."**—Ever since our Civil War, powerful economic factors have caused our corporations to become larger and larger. A similar tendency has more recently been seen in Great Britain and Germany, particularly since the Armistice. The advent of these so-called "trusts" has occasioned a considerable readjustment in business methods, and at times they have been attacked as a menace to democratic government. Yet experience has shown us that the mere bigness of a corporation does not as such constitute any offense to the public, nor any inherent danger to its welfare. The truth of the matter is that resistless economic forces have necessitated

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<sup>5</sup> See Chapters II and IV.



the large corporation today, and we cannot now return to the small business organizations of even twenty-five years ago.

The securities of our soundest corporations were, of course, highly speculative in the beginning. But the American public, believing in the future of this country, has always been willing to speculate in them. From the financial standpoint, indeed, this speculation is mainly responsible for our amazing growth in the past century—a growth which for swiftness and extent is without parallel in history.<sup>6</sup>

**Variety of Listed Securities Today.**—The list of stocks which are traded in on the New York Stock Exchange today is a striking illustration both of the vast extent to which modern American business is carried on by stock corporations,<sup>7</sup> and the importance of our stock markets as distributing centers for their shares and obligations. Apart from the numerous steam railroad and electric traction company stocks, the group loosely designated as “industrials” includes shares in companies which operate in finance, retail selling, security-holding, telephones, telegraphs, gas, terminals, electric light and power, coke, rubber goods, tires, magnetos, carburetors, automobiles, fire engines, tractors, motor trucks, auto bodies, auto wheels, radios, airplanes, machine tools, plows, cane and beet sugar, cotton oil, ice, fisheries, fruits, candy, corn products, tea, biscuits, meats, and refrigerating service.

Other listed stocks represent companies interested in steel, iron, fertilizers, drugs, chemicals, harvesters and all kinds of agricultural machinery and implements, cans, brake shoes, locomotives, steel springs, steel cars, pneumatic tools, fuels, scales, tankers, air brakes, elevators, cast iron pipe, enameled goods, the production, refining, and distribution of petroleum, zinc, lead, copper, silver, gold, coal, metal smelting and refining, shipping, foreign trading and foreign securities, land development, snuff, cigars, cigar stores, tobacco and its various products, temperance drinks, woolens, dry goods, linen collars,

<sup>6</sup> See Chapter V.

<sup>7</sup> Appendix Id.



carpets, hosiery, shirts, underwear, hides, leather, shoes, bank notes, express service, safety razors, writing paper, magazines, graphophones, office appliances, docks, glass bottles, typewriters, real estate, and perfumery and toilet articles. And almost weekly the list grows with the addition of the securities of new and different enterprises.

The bond issues listed on the Stock Exchange are even more numerous than the stock issues, for in addition to a vast range of corporate bonds, the list contains the loans of governments, provinces, or cities on every continent in the world except Africa. While foreign government obligations have been listed extensively on this Exchange only during recent years, already they have become sufficiently numerous to make this one of the principal markets for foreign government bonds in the world. Many foreign company bonds and shares have also been recently listed. On the New York Stock Exchange each day, prices are established for the obligations of practically all the leading nations in the world, to say nothing of their provinces and cities, and also for the stocks and bonds of practically all known forms of large-scale business enterprise. The modern investor thus has placed at his ready disposal a range of possibilities for investment which literally reaches "from China to Peru."

**The Chief Kinds of Securities.**—From the standpoint of the relationship between the investor and the thing in which he invests, Stock Exchange securities may be divided into two principal classes—bonds and shares. In America the word "stock" is ordinarily used to denote shares, but in England these two terms are not thus synonymous, and "stock" usually refers to governmental or corporate debts. Occasionally the word is employed with this English meaning in the United States, as for example, "New York City Stock."

**Bonds.**—Bonds represent a debt of a government or a business company. As the bond certificate usually states, the given

governmental unit or company acknowledges that it owes the holder a certain sum of money, and agrees to repay it by a certain date and under certain conditions, meanwhile promising to pay a stipulated rate of interest. Bonds whose maturity date is in the near future are sometimes called "notes." If a bond is unsecured, it is called a "debenture." Many bonds, however, are secured by mortgages or specific pledges of property or sources of revenue, which the holders of such "mortgage bonds" may seize if they do not regularly receive their interest, or at the bonds' maturity the repayment of their principal.

With company bonds, the bondholder is thus a creditor of the concern but not a partner or participant in it. Normally, the bondholder has no voice in the councils of the company, nor can he be said to own any part of the business. But his interest must be paid to him before stockholders can receive any dividends, and should the company default upon these interest payments on its bonds, the bondholders may take over the business or see that it is reorganized so as to protect their claims against it as fully as possible. In any case, the company owes to its bondholders not only this interest but also the nominal value of the bonds, or this nominal value plus a premium to be paid on their retirement. But the company owes its stockholders nothing, and in the liquidation of a business they can lay claim only to what may remain after the concern's debts have all been paid.

There is an almost infinite variety in the exact terms under which bonds are issued, and the preceding paragraphs are open to the same criticism to which generalizations concerning a complex and subtle subject frequently are. It is not within the scope of this study to discuss the innumerable variations in bond indentures comprehensively, and only a few of them will be mentioned here.

A few bond issues abroad have no maturity date, and represent a perpetual debt; the  $2\frac{1}{2}\%$  British Consolidated Debt

("Consols") and 3% French irredeemable *rentes* are outstanding examples. Also many bonds provide for their possible retirement before their stated maturity date; this may be done by the debtor-organization repurchasing its bonds in the open market, or by retiring a certain number of the bonds according to a regular schedule through the operation of a "sinking fund," and at a stipulated price. The latter operation is carried out by drawing the numbers of the appropriate or stipulated amount of the bond issue by lot, and (if the bonds are in bearer form) publishing these drawn numbers in the papers. The "drawing" of a given bond in this way may be either an advantage or a disadvantage to its holder, depending upon whether the current market price of the bond is below or above the retirement price. Naturally, other factors apart, bonds retirable in this way are apt to experience more stable price levels than issues without such a provision.

Ordinarily, bonds must pay a fixed rate of interest. Some bonds, however, are issued with "share warrants" attached, which gives to the bondholder the privilege of purchasing shares of the company under certain conditions, and there are other exceptional cases where special rights and privileges attach to ownership. Certain American companies which have been reorganized have issued "income and adjustment" bonds, whose interest need be paid only in case current earnings are sufficiently great to permit it; with these bonds, interest payments can be suspended without forcing the company into bankruptcy. Other bonds contain conversion privileges, whereby they may under stated conditions be exchanged for other securities—particularly common stock; such "convertible bonds" may fluctuate in price as actively as the stock into which they are convertible, in case the conversion privilege is profitable to exercise. As a whole, however, bonds are usually more stable in price than shares, because of their fixed rate of interest and their compulsory clauses in regard to its payment.

There is also great diversity among company bond issues

in respect to their priority to earnings, and in the event of liquidation to assets. Volumes could be written on this subject alone. American railway bonds present unusual complexities in this respect.

The money in which the interest or the principal of bonds is payable, is also frequently an important consideration. Some bonds specifically provide for payment in gold—a feature which is apt to become highly significant in case the given currency suddenly abandons the gold standard and in terms of it gold goes to a premium. Sometimes, too, bonds are made payable in a foreign currency, or in several different currencies at the option of the holder. During the currency troubles in Europe after the war, this aspect of many European bonds proved highly important in determining their current value.

**Shares of Stock.**—In complete contrast to bonds are shares of ordinary or common stock. Such shares do not, like bonds, represent a debt owed to their holders by the issuing company, but rather the company equities of which the shareholders are the owners. A shareholder is therefore really a partner in the given business enterprise, rather than a creditor of it. The company is under no necessity (unless such an arrangement is specially stipulated) of repaying the nominal value of the shares to their holders, and indeed American shares frequently have no par value anyway. An almost equal latitude (again apart from special stipulations to the contrary) is enjoyed by the company in respect to what dividends shall be paid to shareholders, or indeed whether any dividends at all shall be paid. On the other hand, the possible dividends which a common shareholder may receive are not usually limited as in the case of bonds. The amount of the dividend to be paid on common stock is usually determined by the directors of the company, subject to ratification by a majority of the stockholders. Thus shares as such are attended with more risk than bonds, but possess greater possibilities of profit.



In Europe it is quite exceptional for shares to be issued without some par or nominal value, and this was until the twentieth century also the situation in the United States. In recent years, however, no-par shares have become very prevalent here among the major American industrial and other companies. To some extent this tendency here has provided material for controversy. Advocates of continuing the older practice declare that it is necessary to have a par value for shares in order readily to determine the amount of share capitalization, and for other purposes. On the other hand, those who prefer the new practice declare that since shares are not as a rule repayable, such a par value is unnecessary, and also that such great disparities occur between par and actual or market values for shares through emphatic success or lack of success in the company's affairs, that a par value only misleads the public as to the shares' actual worth. For the purpose of this study, it is only pertinent to point out the increasing popularity of no-par shares. Of the 1,142 American share issues listed on the New York Stock Exchange on January 1, 1929, there were 664 par and 478 no-par share issues.

Ordinarily, American common share issues convey to their holders a pro-rata vote in the proceedings of the company. But to this general theory there are certain qualifications in practice. Multiple-voting shares are nothing like as usual here as abroad. But since the war, American corporations have in certain cases put out double common stock issues called "A" stock and "B" stock, only one of which may possess the voting privilege. This new practice has in turn been attacked on the ground that it unfairly deprived common shareholders of their vote, and defended on the ground that few such shareholders in practice ever actually vote or care anything about voting.

Common stock is of course the most fundamental of all corporate securities. Every corporation must have common stock, while it need not necessarily have bonds, preferred stocks, or other securities. Theoretically, common stock is usually



perpetual in character, and represents the equities of the company as far as these are not subject to bonds, preferred stocks or other senior securities. In order that a stock issue may be conveniently dealt in, it is divided into a definite number of equal shares. The actual market value of the given share at any given time will depend upon its proportionate claim to dividends paid and net earnings obtained, and to the equities of the company, rather than to any nominal or par value which may be assigned to the share. As a convenience to dealings, common stock issues will sometimes be "split up" into a greater number of shares by allowing the holder of "old shares" to exchange them according to a stated ratio for "new shares." This of course usually occurs in the case of very prosperous concerns, the price of whose shares has become inconveniently high. The reverse process is sometimes followed with companies whose shares have fallen to low levels, and here a fewer rather than a greater number of "new shares" will be obtained in exchange for the "old shares"; such exchanges are often made in the course of serious corporate reorganizations.

**"Rights."**—Corporations sometimes find it possible and desirable to obtain additional capital through the sale of additional amounts of common stock. This is usually done by giving existing common stockholders a privilege or "right" to subscribe to the new stock in proportion to their several holdings of the existing stock. In case a company with 1,000,000 shares of common stock decided to issue 100,000 additional common shares, the holder of, say, 100 shares would thus obtain the right to buy 10 new shares at a "ratio of 10 to 1."

The price at which an old shareholder can subscribe to new stock in this way must of course be fixed. Naturally, if a "right" is to possess any market value, this subscription price must be less than the existing market price.<sup>8</sup> The period during which such a "right" may be exercised depends of course on the circumstances in each case, but it is often sufficiently

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<sup>8</sup> Appendix Ie.

long to make it helpful to prepare certificates for the "rights" and list them on the Stock Exchange. For this reason, at almost all times dealings are going on there in "rights" to issues already listed. Such dealings of course terminate with the expiration of the subscription period, because thereafter the privilege of subscription conveyed by the "right" is withdrawn and the "right" certificates become valueless. "Rights" or "subscription warrants" are sometimes attached to securities other than common stocks, although such cases are somewhat exceptional.

**Preferred Stock.**—American corporations have very frequently issued "preferred stock," which from the investor's standpoint partakes of the nature of both common stock and bonds. As a rule, preferred stock never pays more than a stipulated rate of dividend, irrespective of the dividends paid on the common stock. Sometimes, however, preferred stocks have "participating" or other similar features, whereby the rate of dividend paid on it is subject to increase over the regular rate, in proportion as larger dividends are paid on the common shares.

Preferred stock is not an obligation of the issuing company, and the omission or "passing" of a preferred dividend payment does not indicate that the company is insolvent. Thus, preferred dividends cannot be paid unless all bond interest has been paid. On the other hand, dividends on common stock cannot be paid while preferred dividends are in arrears. With "cumulative" preferred stock, even though a dividend or dividends may be passed, they "accumulate" on the stock, and must all be paid off before any common stock dividends can be paid. But with "non-cumulative" preferred stock, no such privilege is extended, and as long as preferred dividends are being paid currently, common dividends may also be paid, even though previously preferred dividends have been omitted.

In case a company is liquidated, the first claim to its assets is enjoyed by its creditors: if sufficient assets remain after the

company's bonds have been repaid, preferred stockholders have the next call, and common stockholders must take what remains after preferred stockholders have been satisfied.

There is in practice too wide a variety in the terms according to which preferred stocks are issued, to make generalizations concerning them altogether easy. Some American companies issue "first" and "second" preferred stock issues, at the same or at different dividend rates. Many preferred stocks are in their indentures accorded features ordinarily associated with bonds, such as convertibility into common stock, or retirability at a price. Usually but not always preferred stocks in America have no vote. Some preferred issues acquire the vote in case their own dividends, or the common stock dividends are passed, or in case the ratio of company net earnings to the amount of the preferred dividend falls below a certain point. The truth is that preferred stock in America as abroad is really an intermediate form of security, partaking of the nature of bonds as well as common shares, and in all cases the careful investor in preferred stock should thoroughly study the exact provisions attending each particular security issue. Theoretically, a preferred stock entails less risk, and is attended by greater stability in market price, than a common stock. Practically, however, there are many exceptions to this rule.

**The Chief Forms of Securities.**—A feature of securities frequently overlooked, yet highly important in its effect on Stock Exchange operations, is the form in which they are issued.<sup>9</sup> Essentially, there are three chief forms for securities: (1) "inscribed"; (2) "registered"; and (3) "bearer."

Inscribed securities are mainly peculiar to Great Britain, and are practically unknown in the United States. No security certificates at all are issued for them, and evidence of ownership depends directly and solely upon the entry of the owner's name in the register of the issuing company or government. Transfer of such issues thus consists, not in the delivery of

<sup>9</sup> Appendix If.

certificates, but only in changing entries on the security register. In respect to danger of theft or loss, inscribed securities are undoubtedly the safest form known, since there is no certificate to steal or mislay. Dividends are paid by mailing checks to security holders.

**Registered Securities.**—Registered securities resemble those which are inscribed, in that a register of holders is kept, upon which the names of holders can be transferred when changes in ownership occur. But, unlike inscribed issues, registered securities have certificates which may be and are deliverable in the stock market. Each registered certificate is made out in the name of the same individual or concern which stands on the register as the owner of the given securities, and thus the registered certificate serves as documentary evidence that the holder whose name it contains is also entered on the register as at least nominal owner of the given bonds or shares.

Practically all American share securities are in registered form; most American bonds are "to bearer," although some of them permit of conversion into registered bonds. In Great Britain, almost all share issues are registered, although the British Companies' Act specifically provides for "share warrants" or bearer shares, and a few British companies have issued them; British bonds, however, are very largely registered or inscribed. On the Continent, registered securities are much less common than in the English-speaking countries; as a rule, Continental securities are registered only when some liability attaches to ownership (as in the case of part-paid shares) or under other exceptional circumstances.

The methods of paying dividends or interest on registered securities vary according to the banking practices of different countries. In most English-speaking countries (including the United States and the United Kingdom) the public is thoroughly familiar with deposit and checking accounts, and in consequence money checks can be mailed to the holders of registered securities as dividend or interest payments become



due. In Continental countries where the people do not ordinarily maintain checking accounts at the banks, registered certificates usually provide coupons for the collection of interest or dividends; in other cases, registered certificates are stamped at the banks for such payments.

|                                                                                                                                                                |                                                                                                                                                                                                           |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <i>For Value Received</i> _____ <i>hereby sell, assign and transfer unto</i>                                                                                   | <i>Notice</i><br>The Signature to this Assignment must correspond with the name as written upon the face of the Certificate in every particular without alteration or enlargement or any change whatever. |
| _____ <i>Shares</i><br><i>of the Capital Stock represented by the within Certificate</i><br><i>and do hereby irrevocably constitute and appoint</i>            |                                                                                                                                                                                                           |
| _____ <i>Attorney</i><br><i>to transfer the said stock on the Books of the within named</i><br><i>Company with full power of substitution in the premises.</i> |                                                                                                                                                                                                           |
| <i>Dated Aug. 2 1929</i>                                                                                                                                       |                                                                                                                                                                                                           |
| _____ <i>Jenkins &amp; Co.</i>                                                                                                                                 |                                                                                                                                                                                                           |
| <i>In Presence of</i><br>_____ <i>John Smith</i>                                                                                                               |                                                                                                                                                                                                           |

Figure 1. Assignment Form

Methods of transferring registered securities vary greatly between different countries, and are often slow, expensive, and beset with formalities. In England, registered certificates are transferred by deed, like real estate. In America, very superior methods of transfer have evolved. On the back of American registered certificates a blank assignment form is provided (Figure 1), which the seller whose name appears on the face of the certificate can sign. Once this signature is endorsed by a bank or a Stock Exchange firm, the certificate can be delivered in the market almost as freely as if it were in bearer form.



Transfer need not necessarily occur at once, and often does not until it becomes desirable to change the entry on the register in order to avoid complications with dividend checks. For this reason, in Wall Street transfers are apt to be particularly heavy in a stock issue just before the "books close for dividends." Between these dividend periods, registered certificates may circulate in the market made out in the name of an original holder, and each subsequent seller (provided they are regular security dealers there) simply stamps or signs his successive endorsement on the back of the certificate. Certificates of this sort, made out in the name of some Stock Exchange house, are called "Street certificates." Often, but by no means invariably, registered certificates in the name of a Stock Exchange firm represent stock held by a brokerage customer on margin, while those in an individual name represent stock held outright by some investing person or concern. This practice, mainly confined to America, makes our registered issues almost as readily negotiable as bearer issues, and still retains for their owners the very great protection against theft or loss inherent in the registered form of certificates. Registered certificates in other countries may be as safe as ours, but nowhere can they be negotiated so readily and efficiently.

**Bearer Securities.**—Bearer securities, as their name implies, are the property of their holder, like bank notes; no register of their holders is or could be kept, and no names of holders appear on their certificates. Abroad, bearer securities are the rule, both for bonds and shares, in all Continental countries, and they are also widely used in Great Britain. In the United States, almost all bonds are in bearer form, and only occasionally are bonds registered. But the European form of "bearer share" is unknown among American companies, and the only examples of such certificates in New York are foreign securities imported from abroad. So completely has this country followed British precedents favoring registered shares, that until recently it was even a controversial question whether

bearer shares were really legal here. The Hofstadter Bill enacted in Albany in 1927, however, gave legal recognition to bearer shares in New York State.

Since with bearer securities no register of holders can be kept, such holders are at any time unknown to the issuing government or company. Therefore, interest and dividend payments on bearer securities are ordinarily made through coupons attached to the bearer certificate. Also, when bearer securities are drawn by lot, or when rights, etc., are issued on bearer shares, holders of these securities can be reached only by public advertisement. It is likely that countries with relatively small geographical area can for this reason employ bearer shares more satisfactorily than nations of great geographical extent like the United States, or of vast international distances like the British Empire.

Bearer securities are superior in their ready negotiability, since they pass by delivery without transfer formalities. To some extent foreign economists are justified in looking upon them as a higher evolution in the form of securities, since until finance became impersonal they could not of course be employed. This view, however, has more bearing abroad, where methods of transferring registered securities are so slow and beset with formalities, than it has in America where the handling of endorsed registered certificates in blank has been so highly perfected. The principal drawback to bearer certificates is, of course, the danger that they may be lost or stolen, for in this case the owner has as a rule very little real protection.<sup>10</sup> In this country, as well as in England, the phrase "to bearer" on the certificate is interpreted quite literally, and it is usually very difficult for one dispossessed of his bearer securities by theft or loss to recover them. In certain European countries where bearer certificates are almost exclusively employed, elaborate systems for stopping payment on certificates alleged to have been lost or stolen, have been developed. The French, for

<sup>10</sup> Appendix Ig.

example, have a practice of "*opposition*" whereby the publication of the given certificate numbers in an official bulletin (*Bulletin des Oppositions*) almost automatically halts negotiation of the certificates, or payment of their coupons. But, at least to the American view, such protective systems strike directly at the very negotiability and liquidity which are the chief virtues of bearer rather than registered securities.

**Conclusion.**—The twain roots of our modern stock markets therefore arise from the gradually developing systems of public governmental debt and private business enterprise in corporate form. The property in which stock markets deal, represents governmental or company debts, corporate participations, or privileges for acquiring them in the form of "rights." While such property does not necessarily involve the issuance of security certificates (as British "inscribed" issues show), nevertheless such certificates are usually issued either registered in a definite name, or impersonally to bearer. The character of Stock Exchange dealings, as well as their economic effects and consequences, are always fundamentally affected by these basic factors.

## CHAPTER II

### ORGANIZED SECURITY MARKETS AND THEIR ECONOMIC FUNCTIONS

**Antiquity of Markets.**—To establish markets is one of the most ancient and fundamental instincts of civilization. From the earliest times the development of industry has necessarily been accompanied, step for step, by the constant creation and expansion of markets which could distribute the products of industry. Even in darkest Africa the natives, still in a state of savagery, are perfectly accustomed to market places, where the buyers and sellers among them can meet to barter with each other their simple products of the chase and the fields. The oldest civilizations of the world had established market places before written history began. The battered temple pylons of ancient Egypt, for instance, show us the fisherman, the weaver, the potter, the poulterer, the farmer, and the metal-worker bartering their several products in market places centuries before currency was invented.

The markets of the classical world, developing from equally crude and primitive trading, attained a broader scope and a higher degree of organization, and played a more significant part in the processes of civilization, than historians seem to appreciate. The famous Agora, long the center of Athenian political life, where the just Aristides and the shrewd Themistocles were ostracized from the state, was originally a market place which had sprung up at the foot of the Acropolis where the seven roads of Attica converged. Long before Solon instituted the Athenian coinage system, the fisherman from the Piræus bartered his fish here for the barley of the Attican farmers.

**The Roman Forum.**—Such, too, was the origin of the great Forum of Rome, the most famous spot in classical antiquity. (Plate 2.) For half a thousand years all European civilization was ruled from this place. But long before there was any Roman state and while the Romans were still a small and struggling provincial people, this forum had been a market place for cattle. Before the dawn of history the Campagnian peasant drove his herds into what was later destined to be the political center of the world, to barter them for the goods of other traders who also congregated there. There being no currency, goods were at first valued according to the number of cattle they sold for—a custom which was responsible for the derivation of the Latin word *pecunia* (money) from *pecus* (a herd).

But the most remarkable thing about the Roman Forum is that it came again to perform its original function. Centuries have passed since the fall of the Roman Empire. The temples, the triumphal arches, the rostra with the war beaks of the captured fleets of Carthage where Cicero and Antony spoke—all these former symbols of the might of Rome have largely disappeared. The Forum today is a forlorn and desolate spot, marked only by shattered masonry and broken columns. The Roman people itself as a racial entity has long since ceased to exist. But until comparatively recent times the Forum again served as a cattle market—the *campo vaccino*, as the Italians called it—into which the Campagnian peasants again drove their cattle to sell. Thus this spot between the seven hills of Rome, which started as a cattle market, then became the political center of the world, and finally reverted again to a cattle market, affords a striking illustration of how deeply rooted and fundamental market places often are to mankind.

**Marketing in Imperial Rome.**—The purchase and sale of debts and money were conducted in imperial Rome, and perhaps even earlier in republican Athens. It is interesting to note that even in ancient Rome the financial and commercial



markets were already clearly differentiated. Of the nineteen *fora* of Rome, those devoted to the purchase and sale of commodities were known as the *fora vendalia*, while the bankers and usurers (or *argentarii*) used to take their stand in the *fora civilia* or *judicialia*, where political activity centered and where popular assemblies and courts of justice were held. The chief forum of Pompeii reveals to the modern tourist an imposing building where the local money-lenders used to conduct their business. Of the exact extent of financial operations in those days little is really known. But some of the comments upon the daily life in Rome made by the later satirists are of interest to the Wall Street banker and broker of today. "Why," asks Juvenal<sup>1</sup>—no feeble "muckraker," even by modern standards—"do you look as woebegone as Creperius Pollio when he goes around offering a triple rate of interest and can find no fool to trust him?" The perennial outcry that the interest rates are "juggled by insiders" for their benefit is at least as old as Persius, who qualifies a sentence with the significant clause, "if by some crafty trick you flog the money market with a whipcord."

**Mediæval Markets.**—In the Dark Ages which followed the fall of Rome, civilization was too unstable to permit any considerable development of either financial or commercial markets. But in the succeeding Middle Ages, wandering and periodic fairs sprang up in response to the eternal forces of supply and demand, even in the face of precarious political conditions and a hostile theology. As long as the volume of trading was so small that periodic markets sufficed to handle the business, and as long as the goods to be purchased or sold had to be brought into the market for close inspection piece by piece, fairs proved to be the most adequate form of market attainable. But when dealings grew sufficiently active, a permanent rather than an intermittent form of market became necessary. Also,

<sup>1</sup> "Non erit hac facie miserabilior Creperius Pollio qui triplicem usuram præstare paratus circum et fatuos non invenit?" (Juvenal, Satire IX, 11, 6-8.)

"... si puteal multa cautus amarum vibice flagellas." (Persius, Satire IV, 1, 49.)

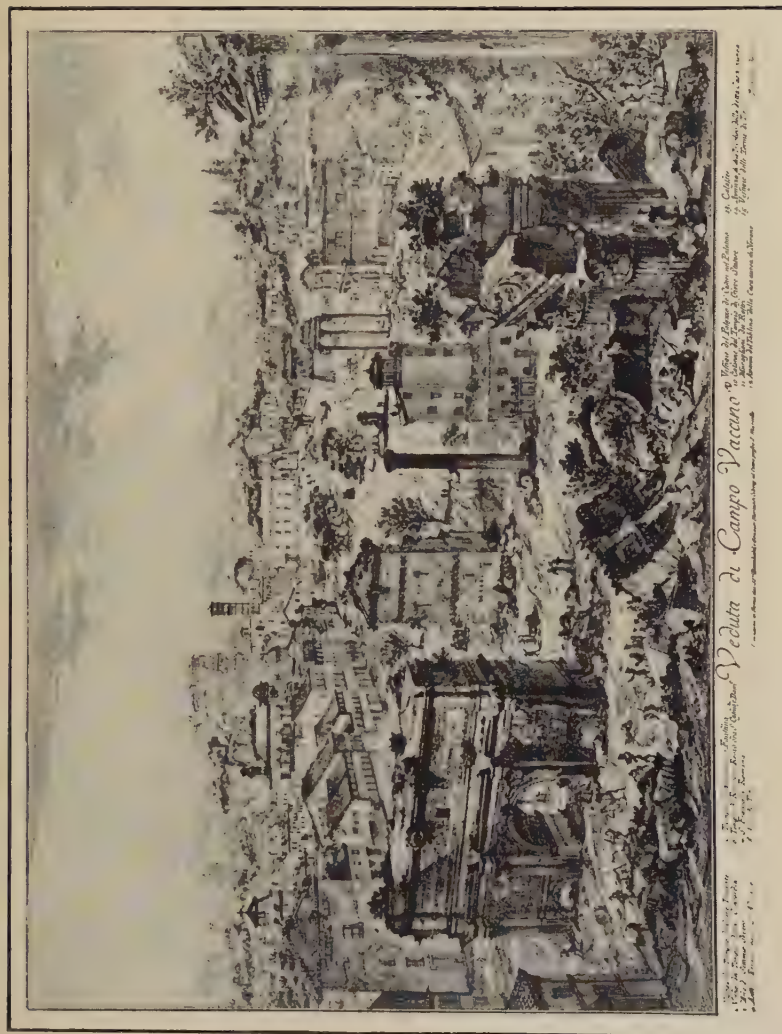


Plate 2. The Roman Forum (18th Century)



in proportion as methods of grading and standardization obviated the necessity of inspecting all products piece by piece, wholesale purchasing and selling by contract and by sample became possible, and the permanent market was able to organize itself more definitely as a *bourse* or exchange.

Thus it came that at the close of the Middle Ages, many of the leading bourses of Europe slowly evolved from the great but periodic and loosely organized fairs of mediæval times. Modern stock exchange practices in many cases can be traced back to an origin in these mediæval fairs, where future trading was to some extent employed, money lending and money dealings of many kinds developed, and a rough and ready justice dispensed to contentious buyers and sellers by the "pie powder"<sup>2</sup> (or "dusty foot" courts)—the historical forerunners of the governing committees of our modern exchanges.

**Civilization's Debt to Market Places.**—The social life and culture of even the most ancient cities cannot be adequately understood without considering them as market places dependent on the ever-shifting routes of trade. Most of the cities of the ancient and modern world—whether prehistoric Cnossus or modern London—have owed their location and much of their political power and cultural eminence to their usefulness as market places for goods. This fundamental relationship of market places to the wider cultural and political aspects of the cities which have in time grown up about them, is most obvious and apparent in the earlier stage of city development. For it was within their market places that the early cities of history often came to set up the statues of their gods, organize armies, talk politics, hold assemblies, and sometimes rule whole empires.

Although often hidden by the rhetorical flights of orators and patriots, the celebration of military triumphs, and even the more enduring artistic and social achievements of the

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<sup>2</sup> An Anglicized corruption of the French *piéd poudré*.

superstructural city life built about it, the parent market place of the city steadily performed its less striking but more basic economic functions. The daily exchange of goods among unremembered merchants, the influx of imports, and the outflow of exports, went quietly on. While on the Acropolis Pericles was planning a greater Athenian empire, while Phidias was carving the white loveliness of the reliefs on the Parthenon, or while Plato was discoursing of immortality in the Academy, the purchase and sale of goods proceeded steadily in the Piræus—in the main unremarked by the historians and unsung by the poets, and yet fundamentally vital to the glory and power of the Athenian state.

On the other hand, once its market place had decayed, the city which so often scorned it, so often viewed it as an objectionable congregation of noisy sharpers and rascals, was smitten as if with a palsy. Indeed, the ever-shifting routes of trade and the stern competition between market places have left a wake across the world of ruined cities, of abandoned or decayed communities, of rotting harbors, whence in better days intrepid tradesmen went down to the sea in ships to satisfy the clamor of the market place for the goods of distant lands and strange peoples.

The mere passage of time has not altered this inexorable economic law. The great cities of the present day exist at the sufferance of supply and demand. As market places they arose, and as market places they will continue to prosper, or else go the way of Venice and Carthage. America is still too young a nation to realize the full significance of her market places. There seems no particular limit set against the continual growth of her cities. Yet we too must cherish our market places, lest in the end we learn the bitter lesson which was forced upon the Phœnicians of Tyre or the Greeks of Corinth.

**Evolution of the Market Place.**—The earliest and simplest markets were formed by the congregation in one place of buyers and sellers, driven together by the economic necessities



of trade. These original markets did not in the beginning specialize, but dealt in all kinds of goods and were located for the most part in the open places of a town. Farmers drove in from the country with foodstuffs to sell, weavers displayed their textiles, and smiths their manufactured articles. In time, money-lenders and merchants in credit also came to take part in the market, and facilitate its operations. Markets of this primitive type, at least in foodstuffs, still exist in some American and European cities, and are common in the bazaars of the immemorial East.

But as communication became easier, population (and hence the consumption of goods) greater, political and social conditions more stable and tranquil, and the volume of trading larger, a process of specialization began. At first, of course, this tendency appeared within the single original market place itself. Traders in textiles took their stand in one part of it, traders in foodstuffs in another. Sometimes, in the early international markets of Europe, the division was not so much according to the commodity as the nationality of the dealers. But with the increase in trading, certain commodities which experienced the heaviest trading tended to break away from the single original market, and form separate markets exclusively for themselves.

At first these specialized markets were often conducted in the open streets. But with a further increase in their transactions they have tended to assume the more dignified title of "exchanges," and finally to go under a roof with restrictions upon the membership. In the course of the same evolutionary process, the development of trading in contracts for the receipt and delivery of given commodities on the floors of these exchanges or *bourses*, made it unnecessary to bring into the market place every individual object to be sold. The development of security certificates as evidences of the ownership of a public or a business debt, or of business equities, of course greatly facilitated the development of organized capital mar-

kets, or stock exchanges. As time went on, increasingly strict and inclusive rules were adopted to govern the character of trading on the exchanges, and also methods were gradually established for periodically clearing and settling such exchange contracts in the most efficient and economical way.

**Prerequisites for the Creation of Exchanges.**—Undoubtedly the organized exchange is the safest, the most democratic and the most efficient sort of market known, and represents the highest stage which the evolution of markets has thus far attained. However, an exchange market cannot be readily developed for many commodities or forms of property. Unless an article is widely demanded by consumers and produced in considerable quantities, there will not be sufficient trading in it to justify the creation of an exchange. Moreover, unless it can be readily graded and standardized, trading in it must usually consist only of small retail transactions, and not wholesale transactions by contract on an exchange. Furthermore, many articles, though widely produced and consumed, are too perishable to permit of handling through a highly organized exchange market. Other factors, too, such as the proportion of production or consumption controlled by a single institution, etc., also have a vital bearing on whether or not an exchange can be readily established for the given commodity.

In the gradual and confused process which has attended the higher development of markets, therefore, a considerable number of articles—and in particular, perishable foodstuffs and articles of widely varying quality and relatively small demand—have lagged behind, and have either remained in the old markets made in the street or else have moved back across the sidewalks into the retail stores. Trading in such commodities is usually sluggish and speculation in them occurs on too narrow and limited a scale to afford the fullest economic benefit to the public. In consequence, the risks involved by carrying them are considerable and the profit on their occasional sales for that reason has to be comparatively large.

But with the heavily demanded and more easily standardized commodities, the further evolutionary stage has been attained. As the Hughes Commission report clearly and directly states, "markets have sprung into being wherever buying and selling have been conducted on a large scale. Taken in charge by regular organizations and controlled by rules, such markets become exchanges." These exchanges—or wholesale markets in staple and carefully graded articles—are commonly called "organized markets" because of the elaborate organization, comprehensive rules, and sometimes extensive mechanical equipment which they develop in the furtherance of their business.

Such organized markets developed during the last century in New York City, not only for securities, but also for cotton, cereals, and other staple commodities. All these organized markets are usually called "exchanges" in the English-speaking countries, although they sometimes take other titles, as for example, the Chicago Board of Trade. Abroad, an organized market is usually called a *bourse* (in French), or its equivalent in the given foreign tongue (German, *boerse*; Dutch, *beurs*; Italian, *borsa*; Spanish, *bolsa*; etc.).

**The World's Chief Organized Markets Today.**—When we survey the vast panorama of the world's present-day marketing machinery, it seems indeed a far cry to the weak and localized marketing organizations of a century ago.

In respect to security marketing alone, there are over 200 stock exchanges in the world today, of varying size and degrees of organization.<sup>3</sup> There is not a modern civilized country without its stock exchanges, and the number and size of these organizations in any single country are usually an accurate measure of the given nation's wealth, prosperity, higher economic development and degree of civilization. Indeed, wherever stable government and active business enterprise exist, there is an inevitable tendency to found stock exchanges.

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<sup>3</sup> Appendix IIa.

Even the Russian Bolsheviks, despite their vociferous abhorrence of capitalism, have apparently been forced to reconstitute the Moscow and several other stock exchanges as markets for private capital.

In the United States alone there are over 20 stock exchanges, two of which are located in New York City. The largest American organized security market is the New York Stock Exchange, and the second largest is the New York Curb Market.

Europe, as the continent so long financially dominant all over the world, has almost three times as many stock exchanges as the rest of the world put together. The Stock Exchange in London was for many decades the greatest institution of its type in the world, and even now that the New York Stock Exchange has come in some respects to rival it in size and activity, it still remains unparalleled in the vast international scope of its listings and dealings. The official market, or "Parquet" on the Paris Bourse has long been not only the headquarters for French government and company security dealings, but also a great market for foreign government loans of all descriptions. The Berliner Boerse has played a great part in the rise of Germany's industry during the past half-century, and provides the chief market for German securities. The old Amsterdam Beurs—London's predecessor as the world's premier stock exchange—is still an investment market of keen sagacity and vast international scope. (Plate 3.) The leading market for Italian securities is in Milan, for Belgian securities in Brussels, and for East European issues in Vienna.

The newer and poorer continents, however, show the same tendency to found stock exchanges as soon as political stability develops, and modern business methods are inaugurated. The United States, indeed, has developed organized security markets on a scale rivalling those of Europe. But the young nations of Africa, Australasia and the Americas, and even the



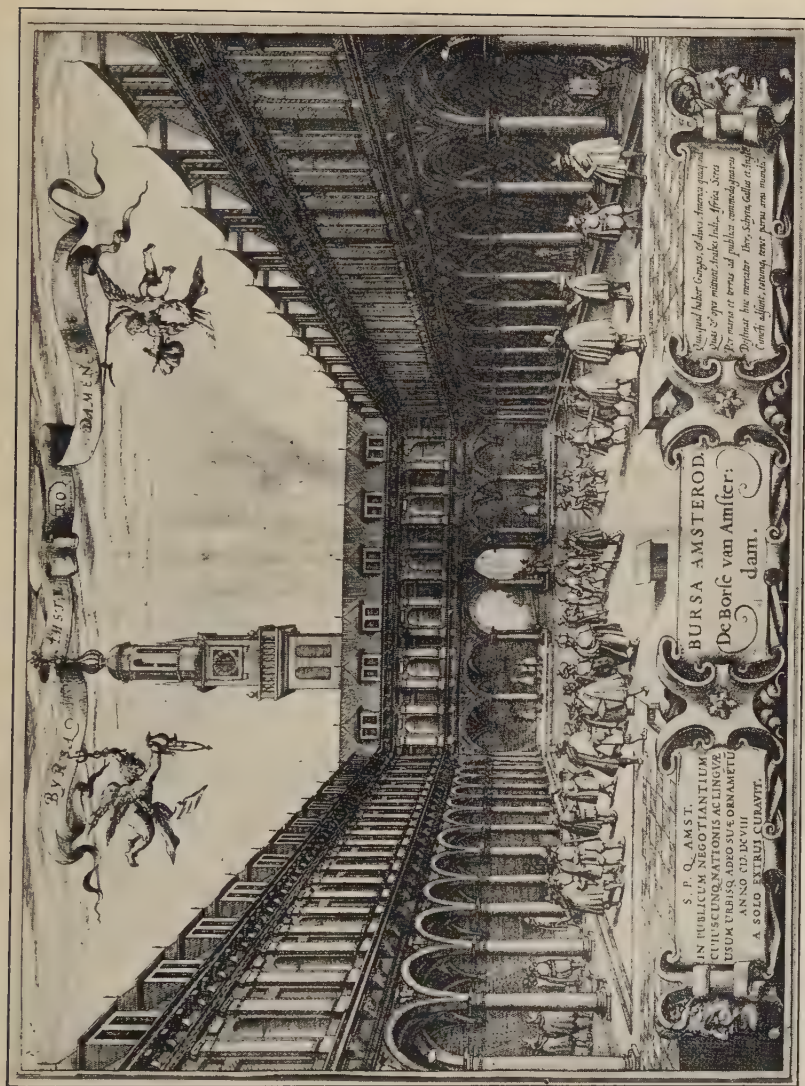


Plate 3. The Amsterdam Beurs (17th Century)





progressive nations of Asia like Japan, have also organized stock exchanges of international importance.

This same trend toward a higher organization of markets could, if space permitted, be instanced with the world's leading staple commodities. Metals, cotton, wool, wheat, corn, rye, barley, pork, sugar, coffee, rice, silk, rubber—these are only the outstanding commodities which have developed produce exchanges. Commodity exchanges in different parts of the world frequently stand in closer relationship than do the corresponding stock exchanges, since the former deal in the same single commodity purchased everywhere, while the latter deal in different security issues of a more localized demand.

**Centripetal Tendencies of Wholesale Trade.**—Wholesale commerce has always shown an inherent and irresistible tendency to gravitate into great trading centers or markets. Predominant markets are therefore nothing new. When America was as yet an unknown wilderness, predominantly active and influential centers for commerce and finance successively developed abroad in Venice, Florence, Bruges, Antwerp, Amsterdam, and London, to say nothing of the many other important but more local European marketing centers. Still further back in history, when America had yet to be discovered and when the Dark Ages still brooded over Europe, there were leading markets in the more civilized areas of the Levant and the Far East. For many centuries it has been found that the more purchases and sales of a particular commodity gravitate into a single trading market, the broader it becomes and the fairer are its prices.

As trade has freed itself from the shackles of uneconomic and frequently mistaken legislation, and as readier means for swift and dependable communication and transportation have been developed, this centripetal tendency of wholesale trade of almost all kinds has been greatly stimulated and increased. The result has been the rise of certain exchanges to a leading position in national and even international trade in particular

commodities. If the price of capital is today mainly established on the New York Stock Exchange in Wall Street, so too the price of cotton is made chiefly on the New York Cotton Exchange in William Street, and the price of cereals chiefly on the Chicago Board of Trade. This higher centralization of wholesale trade, whether conducted on exchanges or not, is a normal and desirable economic evolution, and in the long run legislation should not attempt artificially to halt it. More and more, therefore, in this day of steam railways, telephones, telegraphs, radios, cables, stock tickers and airplane mails, there is a steadily increasing trend toward the centralization of markets, and the subordination of all but the great central market places to more purely local operations. This trend does not, however, necessitate the decline of local markets, but merely develops in them local and special functions which they are best able to perform.

In the United States, the tendency toward centralization of markets is clearly shown by the Federal tax statistics<sup>4</sup> on security and commodity sales, according to which about nine-tenths of stock sales in this country occur in New York City (either on the New York Stock Exchange—the largest American organized security market, or on the New York Curb Market—the second largest American stock exchange, or in the unorganized New York “over-the-counter” market), while a large proportion of exchange transactions in produce occur either in Chicago on its Board of Trade or in New York on its several commodity exchanges.

#### **Economic Functions of Organized Securities Markets.—**

The benefits of the higher organization of securities markets into stock exchanges have been recognized throughout the civilized world for at least the past century, not only by practically all economists who have adequately studied the subject, and by every competent governmental investigation ever made concerning them, but also by millions of individuals in their

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<sup>4</sup> Cf. Appendix IIb.

practical endeavor to invest funds. Nevertheless, it is somewhat difficult to classify even the leading beneficial functions of the organized stock exchanges, because of their considerable number and constant inter-relations. Some of these functions are only more intensified forms of what exists more or less in any market, while still others are peculiar to organized markets. Here the attempt will be made to deal with basic functions only, and many minor services will be left for later chapters to elaborate. The analysis is confined to stock exchanges, but in part, of course, applies also to exchanges for produce or commodities.

**1. Increased Safety of Dealings.**—The higher organization of a stock exchange greatly increases the safety with which security dealings can be carried on, either by its own members or by the public, through its collective regulations, facilities, and discipline. Impossible for practical reasons in an unorganized market, the collective adoption and enforcement of rules are the first task of a stock exchange. Marketing practices upon it are soon standardized, and irregular or fraudulent methods of dealing in securities are sternly stamped out. The membership of the market becomes selective, and persons of improper character or business associations are excluded from it. Forged or fraudulent securities are barred from the market. Insistence is placed upon honest quotations. In these and countless other less important ways, the market in organizing as a stock exchange, becomes a collective force for commercial integrity.

The national effect of this increased safety of dealings created by stock exchanges is to foster security investment, and to develop a broader, firmer, and more active securities market. As its volume of trading increases, the public can deal in the stock exchange through its member-brokerage firms not only more safely but also as a rule more cheaply than in a duller, less organized market. There is, in fact, the same trend toward lowered costs through increased volume of activ-

ity in a stock exchange, that Mr. Ford has made famous in automobile production. As a stock exchange grows, it likewise produces a concentration of collective intelligence and current news regarding security values, which in turn increases the safety of dealings in it.

**2. Superior Marketability.**—Most unorganized security markets are intermittent and spasmodic in operation. But, due mainly to its greater safety of dealings, a stock exchange market tends to become continuous, with the ability to facilitate speedy purchases and sales. For this reason, securities listed on a stock exchange are as a rule much more negotiable than those not so listed, even irrespective of the inherent character of the securities themselves. This is perhaps the most basic economic service rendered by stock exchanges, and is of enormous practical significance. Its full value to business can be gauged only by what happens when the vital quality of negotiability is lacking. It is a well-known and yet frequently overlooked axiom in practical business life that "a thing is worth what you can get for it." Your automobile, for which you paid \$2,500 and which you cheerfully inventory at \$1,500, is in reality worth to you only what you can actually sell it for, whether it be \$2,000 or \$200. It is, of course, equally true of securities, that at any given time they are actually worth what you can sell them for, no more and no less. But there is this important difference. There is no organized market for used cars. If you suddenly find you must sell your automobile, you must call on your friends, and your friends' friends, and skilfully talk automobiles to them. You must consult garages and agencies, and perhaps in addition spend both time and money in advertising your car in the newspapers, in order to find a buyer. In a word, you are forced yourself to create a market in which to sell your automobile.

But when you wish to sell your 100 shares of United States Steel, or any other listed stock for that matter, you can do so instantly and without especial exertion on your part, for



the stock market on the New York Stock Exchange is already organized and is ready at all times to absorb your buying or selling orders.

The usefulness of this quality of marketability which stock exchanges confer upon their listed securities has often been demonstrated by the very different behavior of the organized and unorganized security markets during a crisis. The latter type are "fair weather" markets, which do well enough perhaps while rosy optimism reigns, but which have a disconcerting way of vanishing almost completely when the pressure of heavy selling appears. During a drastic decline in security prices, the loosely organized security markets for the time being simply cease to function. The issues ordinarily marketed there are rendered practically unsalable. Under the circumstances, the banks naturally hesitate to lend funds on such non-negotiable security collateral. But on the Stock Exchange, though prices may fall sharply, security holders can always sell at a price, and furthermore they are more quickly furnished with actual sales prices by which to judge the current value of their holdings. At such times, however, many security holders are apt to sell their Stock Exchange securities to protect their unsalable non-listed securities, and in this way the organized market is forced to bear the brunt of the whole selling movement in all securities.

One important reason for this continued negotiability of listed securities arises from the "short sale," as will be pointed out in more detail.<sup>5</sup> At times, the only buying power in the stock market consists of the so-called "short-interest." No one, as a rule, sells short in an unorganized market because of the difficulty of borrowing stock to deliver, and as a result in such a market holders are not protected in a crisis by the existence of a "short interest." As a rule, also, the superior quotation service of a stock exchange more quickly draws the attention of bargain-hunting investors to securities whose price has

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<sup>5</sup> See Chapter VII, p. 198.

fallen, and by mobilizing their purchasing succeeds more easily in stabilizing the market.

The full significance of this ability of the stock exchanges to render their listed issues instantly negotiable, can be realized only by examining the vast scope and enormous aggregate amount of such listings. The market value of all securities listed upon the New York Stock Exchange during the spring of 1930 amounted to more than one hundred billions of dollars. This gigantic sum is more than the estimated national wealth of any modern country, except the United States and the United Kingdom. It represents the equivalent of between a quarter to a third of our own estimated national wealth. Yet, through the organization of the New York Stock Exchange (including its far-flung ticker wires and the national and even international extension of its members' branch and correspondent offices) any part of this colossal total can be at any time sold under the highest safeguards thus far obtainable in security marketing. Upon this assured marketability, business men and business concerns of countless types continually depend.

Only twice in its long history has the New York Stock Exchange been forced to close its doors—for ten days after the panic of 1873, and for a little over four months during the period of financial chaos in 1914 which followed the declaration of the World War. On the latter occasion, the New York Stock Exchange, although at that time the premier capital market of an international debtor nation, was the last of the great security markets of the world to close, and the first to reopen with all its normal facilities intact and available to the public. In the 1929 crisis, the New York Stock Exchange refused to close, although the overwhelming volume of transactions suddenly thrust upon it led temporarily to a shortening of trading hours and to the establishment of a few special holidays, in order to keep abreast of the work and to give highly trained and irreplaceable employees necessary rest and sleep.

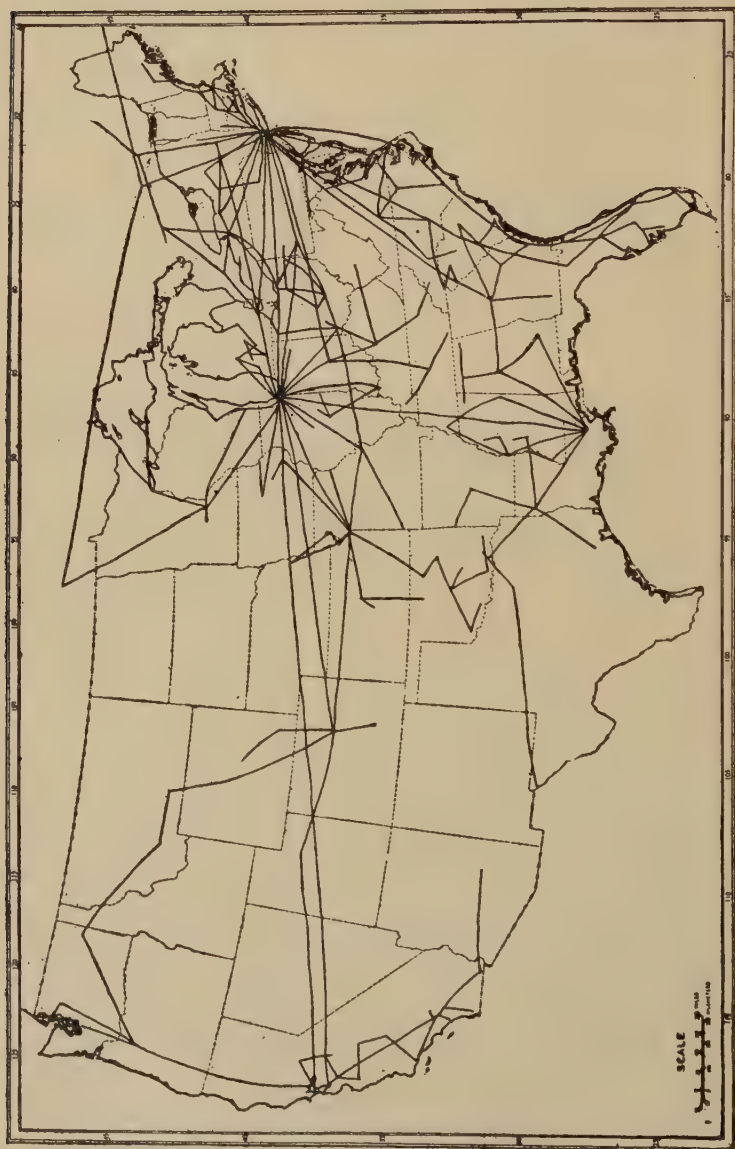
Many delicate financial operations—such as arbitrage—

can be carried on steadily and considerably only in organized security markets. For this reason, the interurban, and particularly the international, traffic in securities, so necessary to stability in the capital market and to the most economic direction of new capital, is particularly dependent upon the establishment and successful functioning of stock exchanges.

**3. Fairest Price-Making.**—The stock exchanges also permit the fairest possible prices to be made for the securities listed upon them. Concerning this aspect of organized markets, Judge Grosscup, of the United States Circuit Court, once said:

The exchanges balance like the governor of an engine the otherwise erratic course of prices. They focus intelligence from all lands and the prospects for the whole year by bringing together minds trained to weigh such intelligence and to forecast the prospects.

The truth of this remark becomes apparent when the contrast between selling an automobile and a listed security is recalled. The car may possess an intrinsic value of \$1,500, and there may be hundreds of people in the United States who would welcome the opportunity of purchasing it at that figure. But this does the owner no good. He cannot locate them and arrange a sale, because there is no organized market through which he can readily be put in touch with them. He must therefore accept whatever price the few buyers whom he is able to interest may be willing to bid for his car, and the highest bid he can obtain may not reflect its actual value. Very different is the situation in a nationally organized market like the New York Stock Exchange, the leased wires of whose members reach to all important centers in the nation (Figure 2). Practically all the possible buying orders regularly compete to raise prices, and simultaneously all the possible selling orders compete to lower them. As a result of the balance struck between these mutually opposing forces, the fairest price to both buyers and sellers results.



(Courtesy of the Western Union Telegraph Co.)

Figure 2. Map of Wire System of New York Stock Exchange Firms

Including branch office and correspondents in cities of over 20,000 population. Duplicate wires are omitted. The concentration of wires at Chicago and New Orleans is due in large measure to the Chicago Board of Trade and the New Orleans Cotton Exchange.

Moreover, the system is self-corrective, owing to the constant speculation in the stock market. Whenever a price of a stock deviates temporarily from its intrinsic value, an opportunity for a profit is at once afforded to thousands of keen and experienced speculators, who are not slow to seize it. If the price is below the value, they buy "for the rise"; while if the price is above the value, they sell "for the decline." As a result of this speculative buying or selling, the inaccurate price is speedily driven back to conform with the inherent value of the security. Inaccurate judgment on the part of the speculator is quickly discouraged by the surest method that could possibly be devised—he loses money. Only in a highly organized market can short sales be readily and safely effected. In consequence, only in such a market do current prices have the full benefit of the free and unhampered interplay of speculative forces.

It is, of course, true that prices established on a great stock exchange reflect collective human judgment, which like all human things may occasionally prove quite in error. It is also true that in markets into which the public freely comes, the collective psychology of the market sometimes may become subject to public excitement. The price movements of such markets up or down are likely to be accentuated by the exaggerated hopes and fears of the inexperienced, just as the roll of a ship is increased by the movements of its loose ballast. Nevertheless, the collective judgment of the public as reflected in Stock Exchange prices is superior to its average judgment, since the stock market is affected by economic as well as merely psychological factors. The convincing reply to those who criticize the stock market as a very imperfect register of security values is, that if their own individual judgments are really so superior to those of the market, they have discovered for themselves a royal road to fortune. Few such critics, however, ever seem to avail themselves of their unique gifts by a practical demonstration in the market.

It is a mistake to associate manipulation with stock exchanges. The more highly a market is organized, and the



more broadly it enjoys public participation, the more difficult becomes the attempt artificially to raise or depress its prices. Professor H. C. Emery, speaking of the failure in Germany to regulate exchanges by legislation,<sup>6</sup> once stated:

The result of this experience was to prove practically what I have maintained for years from my theoretical study of this subject, that the most easily manipulated market is the limited market. The market you cannot manipulate is the big, open, easy, facile market, where everybody can trade with the least restriction. . . . There is no man so big he can manipulate a market into which the whole public comes. The idea that a big man can manipulate a market is greatly exaggerated anyway, but the bigger the market the harder it is for the big man to manipulate it. If the market is bigger than the man he cannot manipulate it. If you have a little market a big man can manipulate it. . . . The big man cannot manipulate a market into which the public comes freely. The public determines the price of the stock in the long run, and the more easily you let the public come in the harder it is for the big man to manipulate.

An experience of over a century in maintaining America's largest and most important organized market has taught the members and governors of the New York Stock Exchange the vital necessity of keeping their great market free and open. In fact, this very phrase—"a free and open market"—is constantly on the lips of Stock Exchange men as an ideal for which they must invariably strive.

**Meaning of "Free and Open Market."**—By a "free" market, the Stock Exchange members and officials mean one which is not dominated by any single man, or any single group or class of men, in defiance of natural supply and demand. Students of the exchanges all recognize that a national and highly organized market, where the full force of the buying and selling orders of a nation is constantly reflected, cannot be manipulated nearly so easily as a non-speculative, unorganized market. A combination of wholesale dealers in fountain pens or shaving soap, for example, could easily adjust the price of the article to

<sup>6</sup> See testimony of Professor H. C. Emery in "Regulation of the Stock Exchange," p. 330.

suit themselves. These articles have only an unorganized, intermittent and sluggishly competitive market, which does not permit of adequate short selling. To counteract an artificial advance in prices there is only the very slow resistance of public refusal to buy. But the would-be manipulator of Stock Exchange securities encounters a very different situation. He is forced by the rules of the Exchange to buy and sell in the open; every price effected by his purchases or sales is instantly reported all over the nation, and if such price becomes at variance with the inherent value of the security, a chance for profit is at once afforded to speculators from coast to coast. The tremendous counterpressure which this national and readjusting speculation exerts, no manipulator or group of manipulators can withstand.

By an "open" market is meant one which is maintained, not for any limited or chosen few, but for every honest investor and speculator in the country—a market, too, where all trades are made in the open and out loud, and not by secret negotiations and whispered agreements. A stock exchange is the most democratic type of market. All buyers and sellers there are put on an absolutely equal footing. Through the ticker system everyone gets the latest news of Exchange transactions as nearly at the same time as the vast area of the United States will permit. As a rule, brokers on the floor do not know at the time whose orders they are executing—whether those of some great capitalist or of some very ordinary citizen; to each they give their best efforts, and only at the close of the day do they perhaps learn from whom the orders came. No member of the Exchange refuses to deal with any other member on the floor. There are no rebates made to wealthy or powerful men, nor any discrimination against the man in moderate circumstances. As we shall see,<sup>7</sup> the Stock Exchange rules establish a minimum rate of commission which all its members' customers—great or small, rich or poor—alike shall pay for the execution

<sup>7</sup> See Chapter XVI, p. 456.

of their orders. Even when a member executes an order for a fellow-member, the commission rate is similarly fixed.

The reader does not need any vast experience in the business world to realize that very few indeed of the articles which he buys possess any such free and open market as this. Indeed, this democratic quality can be possessed only by a highly organized market.

**4. Dependable and Continuous Quotations.**—Through the mechanism of the electrical “stock ticker” machine, the New York Stock Exchange distributes its current quotations all over the United States, and even beyond our national borders. These ticker quotations are frequently reprinted in the newspapers, and are thus made readily available to the whole population of this country practically free of charge. While this instant nation-wide quotation service is unique to the New York Stock Exchange, nevertheless other exchanges perform a comparable service either by means of stock tickers, or else—as abroad—by official daily price sheets. Stock Exchange quotations are gathered, as a rule, with great care and surprisingly few errors. Furthermore, owing to the rigorous discipline of the organized security markets, such quotations represent actual business done, or actual and legitimate bids and offers made. This is in sharp contrast to the security quotations of unorganized markets, which may or may not actually mean anything. Needless to say, it is a very great practical protection to security buyers or sellers, to be able to check their trades against continuous and dependable quotations, and to do so almost as readily on the Pacific Coast as in New York City. Only through an organized stock exchange can such service be assured.

Also, this dependable quotation service provided by the stock exchanges is of great value to individuals who do not happen to be purchasing or selling securities, but who are merely security holders. Such holders obtain current and dependable information as to the course of the market, and can

better exercise their judgment as to the best time to buy or sell. They are put on warning as to the feeling of the market in respect to security values. Without dependable and current quotations, dealing in securities could never be a really rational business. Stock exchange quotations also serve to call the attention of the public to particular companies and their prospects, and by a sort of advertising to interest the public in future ownership of them.

Since 1925, the swift increase in listings and volume of dealings in shares on the Stock Exchange rendered obsolete the old stock ticker machine, and considerable delay was consequently occasioned before the new ticker machines could be perfected and installed. Unfortunately, it was during this interval that the panic of 1929 occurred, when late quotations on the stock tape proved so considerable a source of public confusion. Yet this episode only emphasizes the great service performed under more normal conditions by the Stock Exchange in providing the public with current quotations.

**5. Superior Collateral Value.**—Since stock exchanges confer superior marketability upon their listed securities, and provide current and dependable price quotations for them, it follows that these securities are preferred by money-lenders as security collateral for loans. The lender knows that such securities can readily be sold in case the loan which they secure is not paid, and from their quotations he can assure himself that their marketable value is sufficient for this purpose. This is the reason why securities not listed on a stock exchange are less acceptable as collateral to lenders, even though they may be inherently as sound, or even sounder, than listed securities. Lenders can protect themselves easily against securities of doubtful value, or those selling at high prices, by increasing margin requirements on their security loans and assigning lower prices for the collateral securities as a basis for lending. Thus, the principal danger with such loans which lenders must watch, is the marketability of the collateral. This accounts for

the willingness of lenders sometimes to accept active speculative shares as collateral in preference to more conservative but comparatively inactive investment issues.

A subsequent discussion will cover the significance of security collateral loans to the ready distribution of securities, to the New York money market, and to American business in general.<sup>8</sup>

#### 6. Increased Availability of Capital for Investment.—

The enhanced facilities resulting from the higher organization of a securities market into a stock exchange perform a continuous and important economic service in putting capital and investments into close touch with each other. Due to the nation-wide extension of the Stock Exchange ticker service, and the fanlike spread of wires connecting Stock Exchange member offices in New York with their branch and correspondent offices throughout the country, capital can easily flow into or out of the leading security issues in the American market. This service, of course, greatly increases the national habit of thrift and security investment. It prevents capital from remaining idle, and provides a ready incentive to public security buying that has proved of enormous importance to large-scale American business enterprises, which continually look to public investors for their increasing capital requirements.

Walter Bagehot, in a celebrated passage,<sup>9</sup> declared that :

A million in the hands of a single banker is a great power ; he can at once loan it where he will, and borrowers can come to him, because they know or believe that he has it. But the same sum scattered in 10s and 50s through a whole nation has no power at all ; no one knows where to find it or whom to ask for it.

What is true of a bank is also true in a slightly different way of the Stock Exchange, which as our leading organized security market collects the funds of individual investors and speculators from all over the nation, and even at times from

<sup>8</sup> See Chapter XI.

<sup>9</sup> Bagehot, "Lombard Street."



other countries, and directs their flow into the productive industry of America.<sup>10</sup> Of course, the money does not pass directly from the purchaser of listed securities to the manufacturer, but instead, as a subsequent chapter<sup>11</sup> will demonstrate, through a number of speculative hands, including underwriting houses.

Nevertheless, by making this process possible the Stock Exchange renders every day an indispensable service to the industrial corporations of the nation. Silently, day after day, week after week, year after year, this great flow of capital through the Stock Exchange into industry, and the ebb of dividends, interest, and profits or losses back from industry to the public, goes on. In the past it has spanned our continent with a steel network of railroad tracks—the arteries of our inland transportation system; it has built the vast factories and mills, and sunk the countless oil wells and mine shafts which have made this country the industrial marvel of the century. It has ceaselessly operated to bring forth from the inventor's shed and make available for daily use by the people those inventions which have so powerfully contributed toward making life today more worth living than at any other period in history.

**7. More Intelligent Direction of Capital.**—Until security markets were highly organized, great wastage of capital occurred through its haphazard direction into investment. The stock exchanges of our own times, however, have largely reduced such wastage by the superior market facilities which they have made available to everyone. When the ticker or the daily quotation sheet shows that prices for the securities of one industry are rising and those of another industry are falling, it is usually a clear warning to the modern investor that capital is needed in the first case, but not in the second. Thus simultaneous gluts and scarcities of capital as between different industries are almost automatically prevented, misalignments between the supply of capital and the demands of industry are

<sup>10</sup> Cf. Appendix IIc.

<sup>11</sup> See Chapter IV, p. 116.

largely avoided, and great economies in the use of capital are thus produced.<sup>12</sup>

Very often, the prices of securities on a stock exchange reflect future probabilities rather than present values, and this fact only increases the ability of the market more efficiently to direct capital into industry. Very often, however, this sensitiveness of the market to future probabilities is not sufficiently grasped by the public, and causes losses to inexperienced speculators and investors who, being human, are only too ready to blame the Stock Exchange, the Federal Reserve system, the "international bankers"—or anyone, in short, except themselves.

**8. Greater Stability of Capital.**—The organization of security markets into stock exchanges greatly furthers the stabilization of capital. For one thing, the yields on similar securities tend to become standardized and uniform on a stock exchange, and a general average yield on bonds, and to a lesser extent on stocks, can be more readily determined. This average yield on long-term investments, rough as it sometimes is, nevertheless is an important factor in the whole rate-structure of the money market, and it acts and reacts upon short-term money rates with a general tendency to approximate a uniform level with them. In this way, the organized security markets play a vital part in facilitating the establishment of consistent prices for capital and credit.

The securities on the Stock Exchange, as well as the loans contracted on their collateral, regularly provide a mechanism into which idle and unproductive capital can practically always be poured, and from which liquid working capital can almost always be readily obtained for industry, agriculture or trade. Since capital is in a sense a common denominator of all business, this function of the market for capital on the Stock Exchange possesses a very great economic significance which is only too frequently overlooked. During credit stringencies,

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<sup>12</sup> Cf. Appendix IIId.

the stock market regularly acts as a "shock-absorber" to all business. In many cases, liquidation on the Stock Exchange has released sufficient capital to prevent the shock of a scarcity in working capital being felt practically at all in agriculture, commerce or industry. But even when serious contractions in credit do affect all enterprise, the shock is lessened because the stock market acts as a buffer. A typical case of this sort occurred in 1919-21.<sup>13</sup> In this connection, Governor Benjamin Strong of the New York Reserve Bank stated:

. . . the liquidation in the New York stock market started a year earlier than the liquidation throughout the country; and the effect of it was actually to release credit for purposes such as agricultural and industrial and commercial uses.

On the other hand, the artificial injection of excess capital into land or commodities, with the attendant rise of prices and speculation with serious social consequences, has frequently been prevented or minimized by the ability of the securities market on the Exchange to absorb capital. For this reason, proposals to artificially "stabilize" the stock market would amount to tying down the escape valve of a steam engine.<sup>14</sup>

The claim is sometimes made that funds are attracted into the stock market and thereby denied to commerce, agriculture, and industry. In Chapter XI this question will be discussed in more detail; it is enough here to state that this claim is usually made on very doubtful and imperfect evidence, and at the most involves only short periods of time.

**9. Segregation of the Risks of Capital.**—Owing to the increased safety, stability, and publicity as to security prices created on the Stock Exchange, there has evolved within it and around it specialized dealers in speculative securities, of whom some are members of the Exchange and some are not. These so-called "professionals," being almost always ready to buy or sell, thus collectively provide a ready means whereby the investing public can shift risks to these regular dealers at will. This

<sup>13</sup> See Chapter XI, p. 303.

<sup>14</sup> See Appendix II.

fact permits investors to hold securities only as long as they involve little risk. Thus, the higher organization of securities markets creates an ability to avoid or shift risks somewhat akin to insurance. In an unorganized security market, on the other hand, almost all the risks entailed by security ownership fall squarely on the investor, for when he wishes to shift his risk by selling his security, he often finds that the unorganized market has practically suspended operations.

**10. Barometer of Business.**—Prices on the Stock Exchange have frequently been used as a barometer of future business conditions.<sup>15</sup> So eminent an authority as Professor S. S. Huebner has stated, "Without an exception every business depression in this country has been discounted in our security markets from six months to two years before the depression became a reality."

Frequently, however, the omens provided by Stock Exchange prices have been disregarded by American business men until the crash came, and were then cited as evidence that the Stock Exchange must have caused it. In this way, the Stock Exchange has seemed continually fated to fill the unhappy role of the prophetess Cassandra, whose predictions before the event brought upon her the charge of being both demented and ill-natured, and after the event the inconsistent accusation of having herself caused all the trouble.

This prophetic quality often possessed by Stock Exchange prices has resulted not only from speculative intelligence in the stock market, but also from the inevitable pressure of economic forces. When this collective human intelligence goes astray, as it sometimes does, naturally the barometric value of Exchange prices is lessened. But on the economic side, we have seen that the market on the Stock Exchange is one for surplus capital, and thus expands or contracts before other markets. Normally this recurring process has rendered Stock Exchange prices barometric of future business conditions, since the latter

<sup>15</sup> Appendix II f.



also are usually affected profoundly, although more slowly, by an abundance or a scarcity of capital. But in this respect it is not unlikely that prices on the New York Stock Exchange are not today as sensitive to future business conditions as they formerly were. As long as the United States was a debtor nation, prices on the New York Stock Exchange were extremely sensitive to the influx or outflow of gold, and to every other important shift in the credit situation. More recently, however, the creditor status of this country, by practically obviating the old-fashioned credit shortage in Wall Street, has undoubtedly lessened the forecasting value of Stock Exchange prices, and has sometimes permitted them to remain stable or even to rise before and during a period when average company earnings fell, because excess capital seeking investment outweighed the poorer prospect of an increase in the value of equities.

Thus, it is less safe today to indulge in dogmatic statements as to the inevitability of the barometric value of Stock Exchange prices, than it was a decade ago. Nevertheless, with all these qualifications, as a rule Exchange prices still tend to forecast future business conditions. Moreover, a certain number of business men presuppose that they always do and sometimes guide their business policies accordingly—a fact which to that extent tends actually to increase their barometric value.

**Social Dangers of Organized Markets.**—The principal, if not the only important social danger arising from the evolution of organized security exchanges, lies in just the high degree of perfection to which their facilities have been developed and made available to the public. In this, as in so many phases of American life, it may be that economic and mechanical progress has proved more swift than the social, moral and educational development necessary to adapt our daily lives to it. Anyone can, of course, speculate wildly in second-hand overcoats or tomatoes or almost any other article, as well as in securities. But it is not as easy to do so, because the markets for such articles are not as organized and readily accessible. It is the



truth (but not the whole truth) that the higher organization of markets has sometimes made it easier for reckless and uninformed people to injure themselves through speculation, just as it is easier today to be killed by being run over by a steam locomotive or an automobile than it formerly was by a stage-coach. Yet, just as this latter fact does not constitute a valid reason for urging that steam railways or automobiles be "abolished," or that stagecoaches be again legislated into use, so too there can be little real justification for condemning the stock exchanges because those who use their facilities carelessly or recklessly now and then come to grief. The truth is that people must somehow be taught not to speculate foolishly, just as we are all learning to avoid getting in front of locomotives or automobiles.

**Future Marketing Probabilities.**—The organization of exchanges has been accomplished in comparatively recent times. Yet so important a factor in the economic and social progress of world civilization have they already proved, that not only their permanence in the present economic machinery of the world, but also their continued evolution in the future along significant lines is assured. Great as are their functions and beneficial services to mankind today, nevertheless it is obvious to the economic historian that their present development is only a stage in their larger and continuous evolution. Without indulging in fanciful predictions, it is nevertheless interesting to conjecture along what lines this future evolution of the organized markets is likely to occur.

In the first place, it seems inevitable that the production and consumption of many commodities will considerably increase during the coming century, and that they will consequently come to be considered as staples. It will become more and more dangerous and expensive to buy and sell such commodities in their present loose-jointed, unorganized, and precarious markets, and accordingly exchanges may gradually be established for their more economical sale and distribution. Many

preliminary steps in this direction can already be seen. Every year the marketing of all manner of goods and services is being investigated in a more thorough and scientific spirit. During recent years, several new commodity exchanges have been established in New York and elsewhere. Farmers, too, are everywhere experimenting to effect improved markets for produce of various sorts. Some commodities, either because they are perishable or difficult to standardize, may never develop markets of the most completely organized type. Yet for many other commodities, it is not unlikely that organized exchanges will spring up during the next hundred years. Our present exchanges, whether in commodities or securities, seem likewise destined to experience a steady growth in the volume of their annual turnover, and a more delicate adjustment of their internal mechanism.

**The United States and the World's Markets.**—Secondly, it also seems inevitable that as time goes on, competition between exchanges of like character in various parts of the world will be intensified by the remarkably rapid strides which are now being taken to perfect speed in communication and transportation. As a result, single exchanges more internationally dominant than at present will emerge. The location of such leading world exchanges will depend chiefly upon three different factors—nearness to the main center of supply, nearness to the main center of demand, and nearness to the money markets which enable surplus production to be carried into consumption. Americans can face this probable future evolution with equanimity. When the splendid natural resources of this country, its high standard of living, the vast consumptive demands of its mighty and constantly mounting population, and the rapid development of its money centers—particularly, of course, in New York—are remembered, it seems altogether likely that many of the internationally dominant exchanges of future years will be found within the United States.

If, then, the volume of transactions in organized markets is likely to experience a large increase in the future, whether through the creation of new or the expansion of old exchanges, it follows that the volume of speculation in securities and commodities will increase in proportion. The business man of 2000 A.D. will probably be able with the greatest ease to make short sales of wool or tobacco, or purchase futures in coal and crude oil, whether in the course of his business, or for the sake of speculative profits.

The past century has seen a gradual stabilization in business, largely through the operations of our organized markets. The next century will see the further stabilizing of prices and minimizing of risk. The accomplishment of these desirable ends will depend largely upon the creation and adequate development of organized markets.

## CHAPTER III

### THE RISE OF THE NEW YORK STOCK EXCHANGE

**Earliest New York Markets.**—New York was founded by the Dutch in 1623, not as an asylum for religious or political freedom, but as a trading post. Owing to its splendid natural port facilities, the city had, early in the eighteenth century, become a commercial center of no small importance. Its merchants from the first possessed both energy and vision. As early as 1752, in fact, they had established a general meeting place for merchants, or "Exchange" as they called it, at the foot of Broad Street, for dealings in meal and water-borne produce. An even more significant market place was established on the wharves at the foot of Wall Street (now near the intersection of Pearl Street), where the manufactured goods of Europe were unloaded from incoming boats from abroad, and auctioned off to local merchants. In 1768 the present Chamber of Commerce was organized in the long room of Fraunces' Tavern, which still remains in the financial district as a reminder of pre-Revolutionary Manhattan.

Prior to and during the Revolutionary War, there was no security market in New York, for the excellent reason that practically no securities existed in colonial America. Such capital as then existed flowed into land or goods. Only occasionally did American cities issue bonds; company shares were also thoroughly exceptional, since most business was conducted by individuals or partnerships rather than by stock corporations. In any case, however, the financial facilities of imperial London, capital of the British Empire, were available to British colonies, and until American independence was won, there was

no need of creating rival facilities in the new colonial towns of New York, Philadelphia, or Boston.

These conditions, however, disappeared with British rule. The Revolution had created a heavy American national debt. The first Congress assembled in Federal Hall (where the historic New York sub-treasury building now stands, diagonally across Wall Street from the present New York Stock Exchange building), and authorized the issue of \$80,000,000 in bonds, or "stock" as it was then called, to consolidate and refund the war debt. Thus there came into existence a new form of property, in an amount enormous for those days, for which no regular market existed.

Meanwhile, the financial necessities of the new Republic were leading to the creation of a new financial machinery. In 1781 the Bank of North America was incorporated in Philadelphia. Not to be outdone even by what was then the commercial and financial center of the country, the merchants of Manhattan organized the Bank of New York in 1784. But a still more significant step was yet to be taken. In 1791 Alexander Hamilton, a New Yorker and the first Secretary of the U. S. Treasury, prevailed upon Congress to establish the first United States Bank.

**Origin of the New York Securities Market.**—The scrip stock of this new institution, when it was offered to the public, inaugurated the first wave of security speculation in this country, in which the 6% United States Government stock as well as the shares of the new United States Bank and the Bank of North America were favorites. The frequent purchases and sales of these early American securities created the need of some regular market where they could be more readily and efficiently conducted, for investors were naturally averse to exchanging their savings for securities which could not be easily sold again.

The earliest records of security marketing in New York are meager and obscure. Apparently, securities were first sold



in the ordinary produce and merchandise auctions at the foot of Wall Street—then the chief wholesale markets of the city. But auctions by their very nature are one-sided markets, with competition between buyers, but none between sellers. For this reason, auctioning did not prove an adequate method for marketing securities, despite the fact that security auctions are still held in New York. Also, due to public unfamiliarity with securities, about ten auctioneers and merchants were attracted into the new occupation of acting as agents and brokers for security buyers and sellers. These earliest New York stock-brokers, according to tradition, formed the custom of meeting under an old buttonwood tree which then stood before what is now 68 Wall Street, except when inclement weather drove this tiny curb-market to shelter in the nearby coffee houses. Thus they became accustomed to transact their business with each other and for the public, and to provide as well as they could the ready security market for which the times called with increasing insistence. And thus, for all its present splendid facilities, the New York securities market began very humbly indeed in the rain and dust of a village street.

**First Brokers' Agreement.**—The first sign of an organization in this original open-air market was manifested on May 17, 1792, when the following agreement, still preserved in the archives of the Stock Exchange, was signed by these early brokers:

We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other that we will not buy or sell, from this day, for any person whatsoever, any kind of public stock at a less rate than one-quarter per cent commission on the special value, and that we will give preference to each other in our negotiations.

There are 24 signatures to this interesting document, which is the first stock exchange agreement of any kind in this country.

The stock market thus inaugurated grew rapidly.<sup>1</sup> After playing a vital part in the creation of our earliest banks, the fire and marine insurance companies were likewise presently enabled through its agency to obtain necessary capital. State and municipal obligations were shortly added. The War of 1812 resulted in heavier government debt, more government bonds, and a heavy increase in their purchase and sale in the New York securities market. So rapidly did the security brokerage business grow that steps soon had to be taken not merely to provide for the greater dignity and comfort of the stockbrokers themselves, but also to protect their contracts more completely by restricting membership in the market. To this end the New York street brokers went under a roof for the first time in 1817, and as a part of the further organization which this move necessitated, took for themselves the collective name of the "New York Stock and Exchange Board." The first constitution of this new organization bears the date of March 8, 1817, and among other matters provides that "any members making a fictitious sale or contract shall, upon conviction thereof, be expelled from the board." At this time trading was permitted in only about 30 stocks, and the new association was formed by only 7 firms and 13 individual brokers.

**Original Stock Exchange Equipment.**—The Stock Exchange, however, was still a temporary lodger rather than an established inhabitant of Wall Street, for all the valiant national service which it was performing in stabilizing America's national and local public credit and in helping to find capital for our early banking system. On April 8, 1817, it was "Resolved, that we pay Mr. George F. Vaupell for the use of his front room in the second story of house No. 40 Wall Street, two hundred dollars (\$200) per annum, he to furnish fire and chairs, when required, and to keep the room in order."<sup>2</sup> Further evidence of the leisurely transactions on the "Board"

<sup>1</sup> See Appendix IIIa.

<sup>2</sup> E. C. Stedman (editor), "The New York Stock Exchange," p. 65.

of this period, long before the security market became continuous, is furnished by article 2 of the contemporary constitution:<sup>3</sup>

2. It shall be the duty of the President to call the stocks at the hour that may be fixed upon by the Board, from time to time, as the season may require. . . .

From the scanty records which survive from these early days, it does not appear that the Exchange had any even comparatively permanent home until 1827, when it rented a room in the Merchants' Exchange Building at Wall and Hanover Streets. From this shelter the stock market was, however, rudely evicted by the great fire of 1835. But after several further wanderings, including the temporary occupation of a hay-loft, the Board at length reoccupied in 1842 a large hall in the new Merchants' Exchange Building on the present site of the National City Bank. (Plate 4.) Here it remained until 1854.

**Beginnings of Railroad Development.**—Meanwhile, no sooner had our government established itself politically and financially, than the great task of opening up and settling the vast western areas of the country began. The keynote of this westward colonizing movement was, of course, transportation. At first carriage roads and then canals were constructed from the Atlantic seaboard over the mountains into the fertile hinterland of the Mississippi Valley. In 1825 the completion of the Erie Canal opened up a water route from New York into the Great West and definitely transferred the commercial center of the United States from Philadelphia to Manhattan. Nevertheless, it was not until the advent of the steam railroad that anything like transportation in the modern sense of the term became possible. The year 1829 saw the first train moved by an American steam locomotive in this country, an experiment fraught with the utmost consequence to the United States.

Serious initial difficulty was experienced in raising the large sums of money needed to establish railroad systems. A solu-

<sup>3</sup> *Ibid.*, p. 64.

tion was ultimately found by creating large stock corporations, whose bonds and shares were soon listed on the Stock Exchange. Largely through its efforts they were sold to the investing public, which in this way became creditors and partners in the new companies and provided much of the capital which was required. In 1830 the first railroad stock—that of the Mohawk and Hudson Railroad—was listed on the New York Stock Exchange. Almost simultaneously the older London Stock Exchange began to quote nineteen American railroad stocks—the beginning of the famous “Yankee rail market” there, which did so much to make our present system of railroad transportation in this country possible.

**The Stock Exchange During the Civil War Period.**—Through the fifties the Exchange continued to grow along with the rest of the country. The exploitation of petroleum fields in Pennsylvania created a new class of Wall Street operators and investors, often referred to as the “Coal-oil Johnnies,” while the discovery of precious metals in the West was also soon reflected in the ever-broadening New York stock market. On a single day in 1857 some forgotten chronicler proudly remarked that fully 70,000 shares changed hands in its market. The perennial problem of the Exchange to obtain large enough quarters was also already upon it.<sup>4</sup> In 1863 the New York Stock Exchange Building Company was organized, and it set about to provide a permanent and commodious home for the Exchange, which in the same year adopted its present title of “The New York Stock Exchange.” Owing to its efforts, the market in 1865 moved into a building on Broad Street on the site of the much larger present-day quarters of the Exchange.

But all the new space thus made available, and more too, was soon needed. The enormous issues of irredeemable paper currency put out by the government during and after the Civil War had the immediate effect of inflating and temporarily stimulating American business. New enterprises were started,

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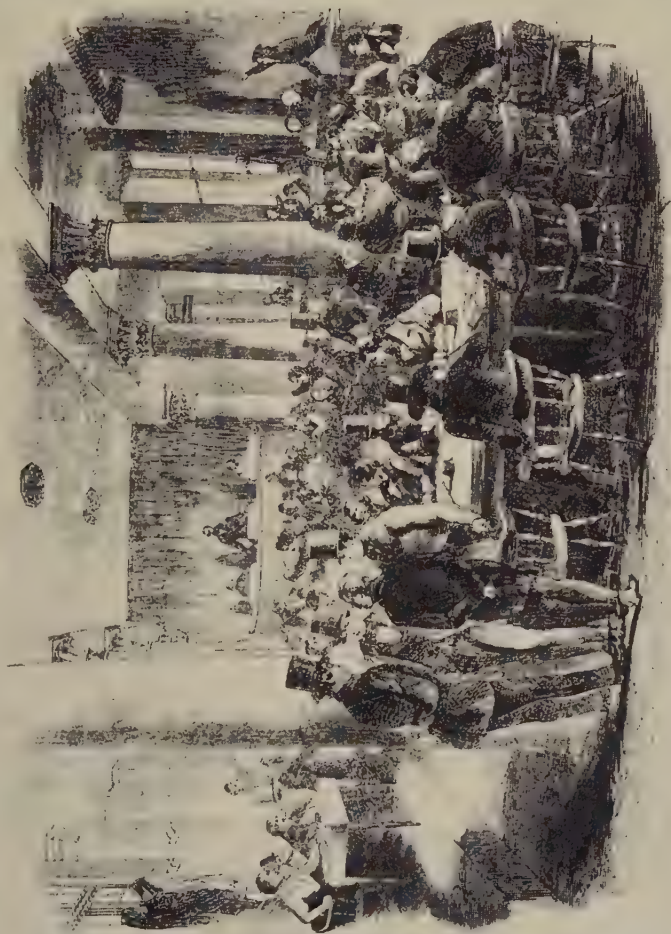
<sup>4</sup> See Appendix IIIb.



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SCENE OF THE STOCK EXCHANGE, NEW YORK.—AM. PAUL. 207.

Plate 4. The New York Stock Exchange in 1853





promoters flourished, and stock speculation overflowed the Stock Exchange into three additional and newly organized minor exchanges: an open-air exchange, the forerunner of the present Curb Market and in some ways like the original market of 1792 under the buttonwood tree; another unique body, which hired the room which adjoined the Stock Exchange and based its transactions on such quotations as it could overhear from the "Big Board"; and lastly, the "Coal Hole Exchange," which derived its name from its subterranean quarters at 23 William Street, where a securities market possessing little formality or decorum but a large turnover was for a time conducted.

This whole post-war period was from an economic standpoint an unhealthy one, with inflated currency a fundamental cause of distraction and unsettlement. This evil was for the most part corrected when specie payments were resumed in January, 1879. In the interim, however, the overstrained conditions of credit precipitated a panic in 1873 which proved so severe that for ten days the Stock Exchange was compelled to close its doors for the first time in its history. Yet it is significant of the growth of Stock Exchange transactions at this period that the present "continuous market" in securities dates from shortly after the Civil War. Prior to that time, stocks and bonds were "called" at intervals during the day, and such trading as resulted in them were supposed to occur, and usually did occur, only after the "call" in each instance.

**Railroad Securities on the Exchange.**—The period of 1850–80, for all its economic alarms and excursions, also witnessed a tremendous increase of railroad construction in this country, which was alternately stimulated and depressed by the tides of economic circumstance. Even before the first railroad train crossed the continent in 1869 and doomed to extinction the Conestoga wagons, prairie schooners, and overland stages, a deluge of railroad bonds and stocks had already swept into the Stock Exchange. To the Stock Exchange the organizers

of our railroads came to obtain the capital needed in laying the vast and permanent steel highways of our inland transportation system. To the Stock Exchange investors looked to give their newly acquired railroad securities an instant negotiability. It is little wonder, then, that until recent decades both the stock and bond markets on the Board have been preeminently markets for railroad securities.

**Expansion of Stock Exchange Facilities.**—The New York Stock Exchange, in the constant effort to perfect its facilities, kept pace with the latest scientific inventions. In 1867 the electric stock ticker was adopted to give speedier, more reliable and more complete publicity to Stock Exchange transactions; gradually these stock tickers were introduced into distant cities, and today they are available even in Florida, California, and Canada.<sup>5</sup> The rising volume of Stock Exchange business after the Armistice led to successive improvements in the ticker service; recently, a much more efficient ticker instrument has been developed. No other stock exchange in the world has such an instantaneous and far-reaching quotation service.

In 1878 telephones were first installed on the Exchange floor to allow of speedier communication between it and the offices of its members. Similarly, the telegraph was speedily adopted to connect members' offices in Wall Street with their branch or correspondents' offices distant from New York, and thus to extend the facilities of the Exchange market. No such facilities for the instant execution of orders originating at great distances from the Exchange have ever been regularly established by the members of any other stock exchange; this development has been particularly necessary in America because of the great geographical distances of this country.

In 1869 the 533 members of the New York Stock and Exchange Board united with the 354 members of the "Open Board of Brokers" (a competitive stock exchange formed in

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<sup>5</sup> See Chapter VI, p. 168, and Appendix VIId.

1864) and the 173 members of the "Government Bond Department" (an organization devoted to dealing in U. S. Government issues), to form the "New York Stock Exchange" with a total membership of 1,060. Membership in the new organization was temporarily limited to this number, although none of the three merged exchanges had previously possessed a fixed membership. In 1879 the membership was increased to 1,100 by the sale of 40 new "seats" to defray expenses in expanding the Stock Exchange building southward along Broad Street. A membership or "seat" in the New York Stock Exchange thus became a species of property owned by the member, and if for any reason he sold it, the net proceeds of the sale went to him.

From 1879 to 1929 the membership of the Exchange was thus limited to 1,100 members. In the latter year, the growth of its business rendered a larger membership desirable.<sup>6</sup> Accordingly, each existing member was given an additional quarter-membership (something like a 25% stock dividend); the 275 new memberships thus created brought the total membership up to 1,375.

Prior to 1869, most administrative measures were submitted to the vote of the whole Exchange membership. But the larger membership resulting from the merger in that year rendered the continuance of this system impossible. Accordingly, the Constitution of the new Exchange installed a representative system of government by vesting the administrative powers of the Exchange in a Governing Committee of 42 members. More will be said in a later chapter about the details of this administrative system.<sup>7</sup>

**Public Utility and Industrial Securities.**—As we approach modern times through the prosperous eighties, another tendency becomes apparent in the stock market. In the wake of the great railroad lines which earlier decades had established throughout the United States, there had sprung up new and

<sup>6</sup> See Appendix IIIc.

<sup>7</sup> Chapter XVI.

progressive American cities which needed gas and then electric lighting, local traction facilities, and telephone service. Accordingly, the thin trickle of public utility securities into the New York stock market broadened into a steady and heavy current. Furthermore, powerful manufacturing industries were being organized, both in our older eastern cities and in the new western centers which our railroads had created and nourished into prosperity. Particularly after the Spanish War, these new industrial companies experienced a rapid growth and tended to evolve into large-scale corporate units with a huge capitalization, and thus with shares and bonds to sell to the public through the indispensable market provided by the Stock Exchange.<sup>8</sup>

**The Rôle of the European Investor.**—As was inevitable in a country so new and for the time being so economically immature, this amazingly vast and swift development of American transportation, American cities, and American industry from 1830 to 1900, completely outran the ability of American speculators and investors to finance it. Accordingly, great blocks of our railroad, utility, and industrial stocks and bonds were absorbed by the wealthier investors of Europe and were listed on the stock exchanges of London, Frankfort, and other foreign financial centers, as well as on the New York Stock Exchange.

Even prior to the panic of 1837, the British had absorbed many of our early and sometimes quite unreliable state bonds, and later even larger amounts of the securities of our leading railroad corporations. After the Civil War, too, the rising financial nation of Germany purchased heavily into our far western railroads, particularly the Atchison, Northern Pacific, and Union Pacific railroads. It is well known that the ultimate prosperity of the northwestern "Hill roads" was largely founded upon heavy buying of the shares and obligations of the

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<sup>8</sup> Appendix IIIId.



original companies by Dutch investors. Many examples might likewise be cited of American utility and industrial securities which similarly found their way into the coffers of European investors. In 1886 the opening of the transatlantic cables at once broadened the market for listed American securities, by permitting the speedy transmission of quotations and orders between Europe and this country. Ready arbitrage was thereby facilitated, and foreign capital was attracted into American securities on a vast scale. Thus the almost incredible swiftness with which this country was built up involved a debt of our corporations to European security-holders of several billions of dollars—a debt whose interest and dividends amounted to several hundred millions of dollars annually.

**Speculative Beginnings of the Industrials.**—Both because the New York Stock Exchange was at that time mainly a railroad market and also because even the best of our new industrial companies were in the beginning intensely risky and speculative enterprises, the Exchange first created an Unlisted Department in 1885, where the new industrial shares which could not altogether meet the increasingly strict requirements of the Committee on Stock List could nevertheless be admitted for trading purposes. Many of the soundest industrial investment securities of today began here as highly speculative and, to the older Exchange members, rather dubious propositions. One of the most striking changes, in fact, which the last quarter-century has witnessed in the stock market is the growing repute of industrial securities and the waning glory of the rails.

A later chapter<sup>9</sup> will describe how and why the growing market first organized its clearing house on May 17, 1892—the centenary of the signing of the original brokers' agreement. In 1903 an important step in architectural expansion was taken by the erection of a new Stock Exchange building. While this

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<sup>9</sup> Chapter XII.

new headquarters for the market was under construction in 1901-3, the Stock Exchange conducted its securities market on the Produce Exchange nearby.

The twentieth century has seen three real panics on the Exchange—in 1901, 1907, and 1929, and serious periods of liquidation in 1903, 1914, and 1920. In 1910 the Exchange abolished its Unlisted Department, and admitted industrial securities to its regular stock list.

During the period of 1907-13, the whole banking and currency system of the United States was extensively surveyed by governmental authorities preparatory to the organization of the Federal Reserve banking system. In line with this movement, critical investigations of the New York Stock Exchange were made—in 1908-9 by the so-called "Hughes Commission" for New York State, and in 1912-13 by the so-called "Money Trust Committee" in Washington. Few really important changes in Stock Exchange methods resulted from these investigations, yet in the long run they proved useful in educating the public in various Exchange methods and problems. Ultimately, of course, the stock market, in common with all American business, greatly benefited by the increased stability of American credit brought about through the enactment of the Federal Reserve Act in 1913.

**Effects of the World War.**—The immediate effect of the outbreak of war in 1914 upon the New York Stock Exchange has been related by its contemporary President.<sup>10</sup> The tremendous wave of liquidation by Europeans of their American securities in this market compelled the New York Stock Exchange on July 31, 1914, to close its doors for the second time in its history. Not until all the great stock exchanges of Europe had closed was this step taken. Trading in carefully restricted securities and with scales of minimum prices began on the New York Stock Exchange late in the autumn. Gradu-

<sup>10</sup> "The New York Stock Exchange in the Crisis of 1914," by H. G. S. Noble (President of the New York Stock Exchange, 1914-19).

ally these restrictions were removed, and the whole market was finally reopened December 15, 1914.

The annals of the Exchange during and immediately after the war period contain many unusual and abnormal episodes. During 1917-19 our entire railroad system was operated by the U. S. Government. In 1917 began the succession of gigantic U. S. war loans. America's participation in the war led to a colossal increase in our national debt, but through the Liberty Loan "campaigns" which the sale of these loans to the public involved, millions of Americans for the first time became familiar with security investment. To assure proper money market conditions during the Liberty Loan flotations, a "Money Committee" was organized by New York bankers, and with the hearty cooperation of the New York Stock Exchange, the call and time loan funds used by Exchange members were artificially stabilized.

Immediately after the Armistice, there was a very active rising stock market in 1919 which crashed sensationally in the fall of 1920, and through most of 1921 remained stagnant. But by 1922 practically all of the "war-controls" had been removed from the New York security market, economic conditions in this country had begun their return to "normalcy," and a period of great domestic prosperity set in. Furthermore, a new international phase of the Exchange's history began. New York banking houses had even in 1915 extended very large loans to foreign governments. During America's participation in the war, this tendency was halted, and our allies borrowed the proceeds of our own Liberty Loans direct from the U. S. Treasury. But after the Armistice, a veritable flood of such foreign government loans came into Wall Street, and the foreign security list of the Stock Exchange grew apace. Soon there were also issued and listed loans to foreign business corporations, and finally even a tendency arose to introduce foreign company shares in New York. Thus the New York Stock Exchange, after having served as an almost exclusively domes-

tic market for about a century, was suddenly called upon to serve as an international securities market.

In 1923 the President of the Exchange inaugurated the practice of issuing an annual report on its affairs. Here comparatively recent changes and developments in Exchange regulations and procedure can be followed in detail. To mention only some of these since 1921: the ticker system was mechanically centralized, extended to California and other distant states, speeded up and provided with a superior ticker instrument; the "questionnaire system" for examining the financial condition of Exchange member firms was inaugurated; the assignable transfer receipt was perfected; the new building in Wall Street was finished and occupied, additional floor space was subsequently provided by another extension to Exchange Place, and finally all properties to the south of the Exchange were acquired by it; a campaign against security frauds was undertaken; the personnel, educational and publicity work of the Exchange was expanded; commission rates were readjusted; the Constitution of the Exchange was completely revised; new listing requirements for foreign and investment trust securities were adopted; regular statistical work bearing on the economic aspects of the Exchange was undertaken; many mechanical accessories to facilitate dealings on the floor were installed; and the Stock Clearing Corporation was greatly developed and expanded. Recognizing the growing significance of the Exchange as an international securities market, its officers have several times gone abroad for purposes of research into the most advanced and successful methods of the leading bourses of Europe. Thus the years which followed the war witnessed the most rapid and extensive period of development in the long history of the Exchange.

**The Panic of 1929.**—The unparalleled increase of business prosperity in the United States during 1924-29 caused a vast expansion in the activity of all the security markets of the country, and an almost continual rise in price of many

American share issues. In the New York Stock Exchange, the number of listed shares trebled, and practically all statistics of its operations established new high records. During the summer of 1929, however, an industrial and commercial recession set in, attended by a steady and world-wide fall in commodity prices. At the same time, huge amounts of new securities, especially common stocks, were issued.<sup>11</sup> No actual credit stringency occurred, but in the technically weakened and overloaded stock market share prices fell, slowly at first and then more swiftly until a very severe panic developed during late October and early November. The course of events on the Exchange during this crisis has been graphically related by President Whitney.<sup>12</sup> Although the Stock Exchange refused to suspend, the tremendous volume of orders suddenly thrust upon the Exchange system caused such congestion in the business and such physical exhaustion on the part of trained employees, that several special holidays were declared, and temporarily shortened hours of trading were employed. Only two small Stock Exchange houses, however, were suspended for insolvency; one of these suspensions occurred about a week after the final recovery from the panic had begun and the other not until over a month afterwards. Neither suspension had any effect in aggravating the severity of the panic through increasing the fears of the public.

**The Stock Exchange Building.**—The building originally occupied by the Exchange (in 1863) extended through the block from Broad to New Streets, but did not reach Wall Street or Exchange Place. Over many years, space was acquired on either side of this original headquarters, and in 1903 a new building was erected on this expanded site. In 1922 a new addition in the form of a 23-story skyscraper was erected, bringing the building to Wall Street. In 1928 further rooms

<sup>11</sup> "The Principal Causes of the Panic of 1929," an address by E. H. H. Simmons, President of the New York Stock Exchange, Philadelphia, January 25, 1930.

<sup>12</sup> "The Work of the Stock Exchange during the Panic of 1929," an address by Richard Whitney, President of the New York Stock Exchange, Boston, June 10, 1930.



were opened which extended its quarters to Exchange Place on New Street. In 1929 the Exchange acquired all the remaining buildings southward to Exchange Place. The accompanying plan (Figure 3) of the whole block bounded by Wall, Broad, and New Streets and Exchange Place, shows the present ground floor of the Exchange where security trading occurs. The bond market, after a stay in the Wall Street addition during 1922-28, is now housed in the Exchange Place addition; the rest of the floor is devoted to dealings in shares. In the basement beneath the Exchange trading floor are the offices of the Stock Clearing Corporation and the vaults of the Safe Deposit Company—another Stock Exchange subsidiary company. Above the trading halls are located the Secretary's Office and other administrative offices of the Exchange, and also its Luncheon Club. Additional space in the Wall Street wing is rented to bankers, brokers, and other tenants.

Visitors to the Exchange, when properly introduced, are usually taken into the Broad Street gallery to watch the Exchange floor in operation. To the right arches open into the Wall Street addition, and on the left lies the way into the bond market. As one surveys the main Board Room from this Broad Street gallery, 12 large stock posts<sup>13</sup> range themselves before him on the floor, to which only members and employees of the Exchange are admitted (Plate 5). The market for each of the share issues in which Exchange dealings are permitted, is definitely located at some particular post. Fringing the floor are the stalls containing hundreds of telephones,<sup>14</sup> which connect Exchange members on the floor with their offices outside by private wire. From the Wall Street commission houses, in turn, privately leased wires extend like a fan to branch or correspondent offices all over the country. This is the mechanism whereby the purchasing and selling orders of the nation can be swiftly directed into the Exchange floor for prompt execution.

<sup>13</sup> Appendix IIIe, and Chapter VI, p. 163.

<sup>14</sup> Appendix IIIf, and Chapter VI, p. 162.



(Copyright by the New York Stock Exchange)

Plate 5. The Stock Exchange Floor (Old Board Room)



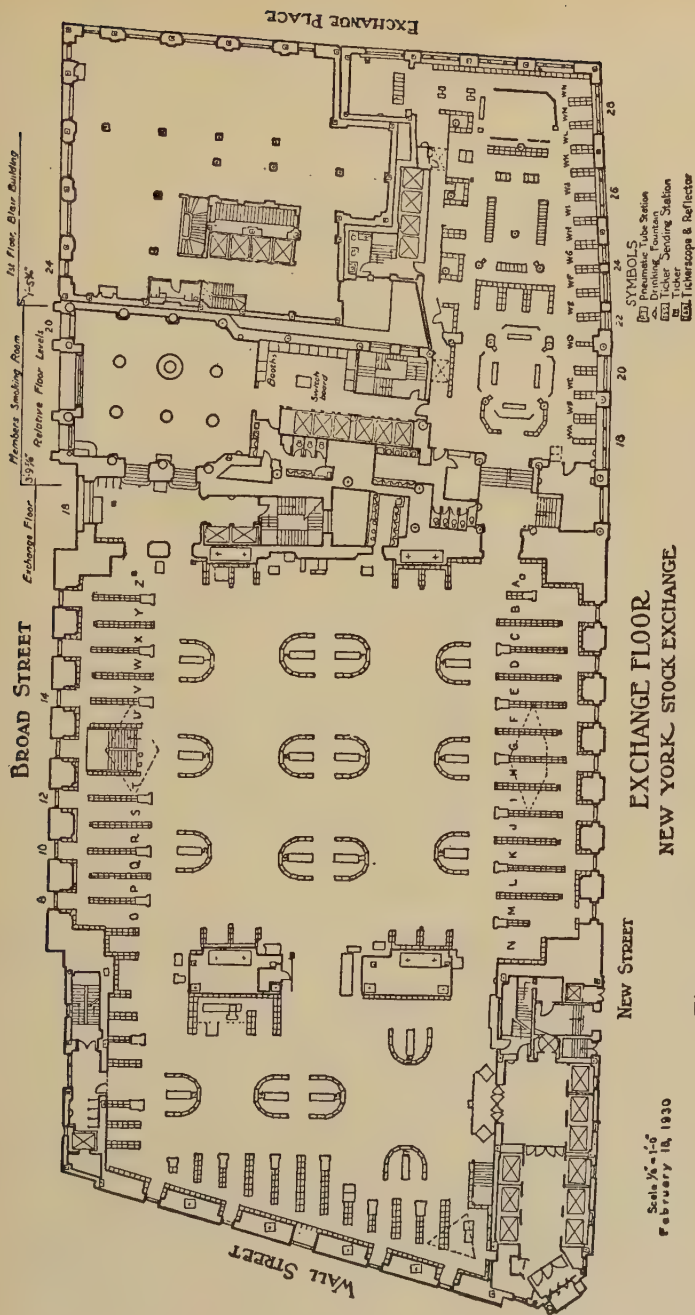


Figure 3. Plan of Ground Floor of the New York Stock Exchange

**Machinery of the Floor.**—Two of the walls of the lofty-ceilinged main Board Room contain enormous windows beneath which the visitors' galleries run. On the other two walls are the large black annunciator or signal boards upon which white numbers are constantly appearing and disappearing; they synchronize with other similar boards in the other trading rooms on the floor. These annunciator boards provide a system for "paging" the members; each member on the floor has his own number, and by flashing it on the various signal boards, his telephone clerk can quickly call him to his telephone from the "crowds" around the posts. On the south wall, below one of the annunciator boards, a small rostrum projects in mid air; it is from here that the opening of the market at 10 A.M. and its closing at 3 P.M. (Saturdays 12 M.) are announced each day by a large brazen gong, and that official announcements are sometimes made to the members of the Exchange. On the floor are also the stations from which quotations printed on the stock tickers are originally dispatched. The floor is provided with tickers for the use of members, and ingenious reflecting devices throw the magnified quotations from the tape on large screens visible to everyone. Numerous other mechanical devices—such, for example, as the pneumatic tube system—have also been introduced on the floor to facilitate its operations.<sup>15</sup>

**The New Floor and Bond Room.**—The above description of the Exchange floor has been confined to the old Board Room, not only because it is the largest and most traditional trading hall in the Exchange, but also because it is the one which visitors usually see. The smaller trading hall in the extension toward Wall Street, being devoted entirely to shares, very closely resembles the old Board Room, and duplicates its mechanical facilities, such as the stock post, annunciator board, ticker dispatch station, telephone booth, etc. The bond room in the extension toward Exchange Place, although resembling

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<sup>15</sup> Appendix IIIg.



the share markets in its general features, is sufficiently distinctive to defer a complete description to a later chapter.<sup>16</sup>

**Restricted Admittance to the Floor.**—The most stringent rules are and have always been in effect concerning admission to the floor of the Exchange.<sup>17</sup> Only members of the Stock Exchange, as well as the bond clerks, reporters and telegraphers, pages, tube attendants and other Exchange employees are allowed on the floor. The telephone clerks, who are employees of members, are forbidden to go on the floor beyond the telephone booths. Clerks of specialists must similarly remain inside the stock posts. Even partners of members, in case of the illness of a member, are with a few exceptions forbidden the floor. This rule is made to prevent the possibility of inexperienced persons standing about the posts and crying out bids or offers for securities, or in any other way interfering with the trading occurring between members. Without such restrictions on admittance to the floor the complete present inviolacy of contracts between members made there could not well be maintained. A gallery is, however, provided for visitors to the Exchange, and any responsible person, after being properly introduced, can from this vantage point watch the activities on the floor.

Of the total Exchange membership, from 500 to 800 members are generally present on the floor. In addition, the floor in the spring of 1930 required the services of approximately 500 pages, 235 reporters, 140 tube attendants, 140 quotation clerks, and 80 bond clerks.<sup>18</sup> Apart from these 1,100 odd Stock Exchange employees on the floor, there are also approximately 1,145 members' telephone clerks, and approximately 200 specialists' clerks.

**Description of an Opening.**—The opening of the market at 10 A.M. provides one of the most picturesque moments in

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<sup>16</sup> See Chapter X.

<sup>17</sup> See Appendix IIIh.

<sup>18</sup> Appendix IIIi.

the day on the Exchange. Shortly before 10 A.M. the employee of the Exchange whose business it is to open and close the stock market, enters the rostrum and takes his seat. On the floor below are over 2,000 people. The brokers and traders gather about the posts—waiting. In the telephone booths along the side walls the telephone clerks are busy with orders for purchases and sales. The black signal boards are flashing one white number after another as the brokers are called to the telephones. A low hum of conversation fills the Board Room. There is a tension in the air, for orders have accumulated in the brokerage houses overnight from all over the country and the opening is, therefore, usually energetic.

Suddenly, exactly on the hour of 10 A.M., an employee of the Exchange in the rostrum sets off the electric gong. The market has opened! Instantly a roar of voices rises as the brokers rush into the "crowds" around the various posts and back to their telephone stalls. Hundreds of men swarm about the posts shouting bids and offers and waving their hands in the air.

Although at first the spectator may think that bedlam has veritably broken loose, if he will follow closely the movements of almost any one of the brokers on the floor he will suddenly realize that the noisy chaos below him is in reality made up of hundreds of orderly though energetic individuals performing their work systematically and efficiently. In spite of the clamor and excitement on the floor, millions of shares valued at many millions of dollars are bought and sold there daily with a negligible number of errors or misunderstandings.

**Brokers and Dealers.**—The casual visitor to the Stock Exchange is apt to come away much impressed with the mechanical appliances on the floor which have just been described, but rather oblivious to its much more important human mechanism. For the securities market is able to function only through the highly specialized work of the several different types of brokers and dealers who go to compose it. Indeed, the day

was when the only mechanical appliance in the New York stock market was the old buttonwood tree—and some skeptical modern historians have even claimed that this had been previously chopped down in the Revolution by British soldiers, and that only its stump remained when the original securities market congregated nearby it!

In all stock exchanges, two chief functions of members are clearly distinguished—brokerage and trading. The broker executes orders to purchase or sell securities simply as an agent for someone else, on a fixed commission. The dealer or trader, on the other hand, has no customers and acts as nobody's agent but his own—that is to say, he buys and sells securities entirely for himself and "on his own account." Brokers make their livelihood out of the commissions paid to them by the purchasers and sellers whom they represent, but cannot make a profit out of any difference between buying and selling prices. Dealers and traders depend entirely upon profits in trading, and cannot receive commissions.

Different stock exchanges regulate the extent to which their members can exercise these two functions in different ways. The *Compagnie des Agents de Change*—the official brokerage organization in Paris—forbids any of its members on the Paris Bourse to act as dealers at all.<sup>19</sup> The Stock Exchange of London divides its membership into brokers and "jobbers" or dealers, and compels each member to be consistently either the one or the other. The New York Stock Exchange allows a member to act either as a broker or a dealer as he will, as long as he does not attempt to act in both capacities in the same transaction. Each of these systems can no doubt be defended in its own particular milieu, but there is little doubt that the American system is the most flexible and the least artificially constrained. Also, in practice, most members of the New York Stock Exchange tend to specialize in one class of dealing or brokerage through the great difficulty in one person's ade-

<sup>19</sup> See Appendix VIIla.

quately and profitably performing many different specialized tasks.

Brokers can be subdivided into several classes, the most important of which is perhaps the commission broker. The latter is usually the "floor member" of a partnership (or "house") whose orders he "executes" on the Exchange. Such "commission houses"<sup>20</sup> differ considerably in the clientele they serve and the type of business they do. Some have a few wealthy customers, while others through their branch offices and out-of-town correspondents handle the smaller orders of thousands and thousands of average investors all over the country. Certain houses also specialize in some group of securities and gain a reputation in—say—railroad, or petroleum, or motor stocks.

**"Two-Dollar" Broker.**—Then there is the "two-dollar broker," who is officially attached to no one commission house, but who makes use of his Exchange membership to assist the commission houses in executing their orders, particularly in heavy markets when the work is too great for the regular commission broker to handle it all on the floor. The "two-dollar" broker is therefore a free lance whose customers are other brokers. His name arises from the fact that his compensation for purchasing or selling 100 shares of stock used to be \$2 out of the \$12.50 which the commission broker formerly charged his customer. Although this former commission rate has been changed, nevertheless the "two-dollar" broker's old title has persisted.<sup>21</sup> The practical value of the "two-dollar" broker is that his work imparts a flexibility and a reserve power to the machinery of the Exchange which it would not otherwise have, and enables the fluctuating number of sales made from day to day to be handled smoothly and efficiently, whether they are many or few.

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<sup>20</sup> See Chapter XV.

<sup>21</sup> See Appendix VIIIc.

**The Odd-Lot Dealer and the Floor Trader.**—As for the dealers, the odd-lot dealer buys and sells less than the trading unit of 100 shares of stock. So complex is his work that consideration of it must be deferred to a later chapter.<sup>22</sup> Then there is the floor trader,<sup>23</sup> who is a free-lance dealer in all stocks listed on the Exchange, and who will buy or sell any of them on his own account whenever he sees the likelihood of a profit in the transaction. The floor trader performs a function very useful in the work of the Exchange, by constantly helping to create close prices for stocks and thus enhance their negotiability. Both the odd-lot dealer and the floor trader act for themselves rather than as agents for other principals, and their earnings depend in consequence upon obtaining a profitable difference between the buying and selling prices of their transactions rather than upon any commission such as the brokers obtain.

**The Specialist.**—Last and most difficult of all to define, is the specialist.<sup>24</sup> Usually the specialist, as indeed his name would imply, specializes as a dealer or broker in a particular security or securities located at a single post. He is not allowed to act as both dealer and broker in any single transaction, and he cannot charge a commission while he profits by the sale of a security at a higher price than that at which it was purchased.<sup>25</sup>

Commission brokers often turn over their orders to the specialist to execute, as a broker and their agent, on the same basis as with the "two-dollar" broker. Some specialists act as dealers in 100-share orders, and occasionally in odd-lot orders as well. In the former case their work resembles that of a floor trader, except that it is concentrated on one stock or group of stocks; in the latter case, of odd-lot orders, they do in their few special stocks what the odd-lot house does in all stocks.

In addition to the above brokers, dealers, and traders in

<sup>22</sup> See Chapter IX.

<sup>23</sup> See Chapter VIII.

<sup>24</sup> *Ibid.*

<sup>25</sup> See Chapter VIII.



stocks, there is also a class of dealers and brokers who specialize in bonds. These must likewise be allotted a chapter by themselves.<sup>26</sup>

**Parts of the Stock Exchange System.**—The various brokers and dealers above enumerated compose the actual members of the market on the floor of the Exchange, where contracts are made for the purchase and sale of securities and for the borrowing and lending of both stocks and money. The floor of the Exchange is the oldest, most central, and most indispensable part of the Stock Exchange system.

But in addition to the floor, there is (2) the clearance and settlement system,<sup>27</sup> embodied in the Stock Clearing Corporation, which provides an efficient and economical method of clearing and settling contracts made on the floor; (3) the commission houses,<sup>28</sup> including their branch and correspondents' offices in all parts of the country and even abroad, through which the public has access to the security market on the floor; and (4) the administrative machinery of the Exchange,<sup>29</sup> including not only many specialized officers and employees of the Exchange, but also several subsidiary corporations like the New York Stock Exchange Quotation Company, the New York Stock Exchange Building Company, etc. These several parts of the Exchange system will be successively treated in subsequent chapters.

**Evolution and Change.**—It is well for the student of the New York Stock Exchange to realize at the outset that, while today it represents the culmination of over a century's evolution, it is a living and growing economic organism in which development and change are constant. Not only must this market accommodate the business of a vast and always growing country, but its specific methods must steadily adapt themselves to new conditions in banking, corporate organization,

<sup>26</sup> See Chapter X.

<sup>27</sup> See Chapters XII, XIII, and XIV.

<sup>28</sup> See Chapter XV.

<sup>29</sup> See Chapter XVI.

commercial practice, governmental finance, and many other varying economic forces which converge upon them.

One corollary of this process of constant evolution in Stock Exchange methods has naturally been a steady improvement in business practices upon it, not only from an economic but also an ethical viewpoint. The fact that progress has occurred, naturally indicates that methods on the Stock Exchange which were formerly looked upon as the custom of the trade, would not be tolerated at all today. It is not unlikely, too, that present methods may gradually undergo similar improvement in the future.

The Stock Exchange makes no idle claims to perfection. It realizes thoroughly that its evolution has not yet ended. It is still deeply concerned, not merely with expanding its facilities, but also with improving its methods and further eradicating the frequently stubborn vestiges of ancient abuses. Yet in its integrity of purpose, its efficiency of operation and its broad economic usefulness, it can without boastfulness invite comparison with any other American business institution. Indeed, it has always compared favorably in this way with contemporary American business, from the slave-holding days of the old brokers under the buttonwood tree down to the present time. Stock exchanges are a very necessary part of the financial machinery everywhere demanded by modern civilization, and it is through no accident that the most cultured and prosperous nations today are those which possess the most and the largest organized securities markets.

## CHAPTER IV

### THE DISTRIBUTION OF SECURITIES

**Listed Securities Considered.**—In a preceding chapter<sup>1</sup> the broad, fundamental economic benefits and services performed by the organized markets have been discussed. But in order to give fuller and more definite illustration of the practical workings of several of these principles as they manifest themselves each day in the Stock Exchange, we must consider in some detail the chief successive stages by which securities are distributed—from their first issuance by corporations until they at last find a permanent resting place in the investor's deposit box. With listed securities, traded in on the Stock Exchange, a very important part of the process of distribution is effected through the Exchange; on the other hand, there is a huge amount of unlisted securities which are not traded in upon the Stock Exchange and in whose distribution the Stock Exchange plays no part whatsoever. These latter securities vary all the way from many gilt-edged and extremely conservative bonds issued by the oldest and most reputable underwriting houses in America, down to the rank fraudulent stocks of spurious oil companies, glass casket concerns, crooked motor and moving picture enterprises, and the like, which swindlers peddle out to the American public in large quantities each year.<sup>2</sup> The present chapter is limited to the distribution of the strictly legitimate although frequently speculative securities which are listed on the Exchange.

**Basis of Corporate Security Financing.**—Everywhere today corporations are constantly in need of fresh capital to

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<sup>1</sup> See Chapter II.

<sup>2</sup> Appendix IVa.

carry on and expand their business. Their frequent need for small sums for short periods can of course be supplied by the banks on their notes and commercial paper, although there has been in recent years a strong tendency to obtain permanent funds by the sale of securities rather than to depend upon short-term banking accommodation. Reorganizations, extensions, or large permanent improvements and the like, usually call for large sums and over long periods, which can be supplied only through the sale of the corporation's stocks or bonds.

Small corporations under exceptionally favorable circumstances are sometimes able themselves to dispose gradually of small issues of their stocks or bonds direct to their stockholders or to purchasers of their products. Such a procedure, however, is impossible with large security issues, and is usually impracticable even with small ones. The large sums needed by corporations must usually be had all at one time rather than in small successive payments over a period of time. Moreover, the average railroad or industrial corporation is apt to lack the long experience and necessary facilities to engage in the security business on its own account. In most cases, therefore, it becomes necessary for the corporation needing extensive and long-term financing to have some investment house underwrite and market its securities.

**The Security Underwriting Business.**—This business of underwriting and marketing new security issues is to some extent carried on in every large city in the country. But the national headquarters of the business—so to speak—is centered in the financial district of New York City, where the great underwriting houses and the Stock Exchange are located. Most of the larger issues of securities, representing industries of national scope and significance, are in consequence "brought out" in that city, while the smaller and more localized banking and brokerage groups in Boston, Chicago, Philadelphia, and lesser centers, for the most part underwrite smaller and more localized enterprises. In addition, as we shall presently observe,

these "out-of-town" centers give invaluable local assistance to the larger New York underwriters in selling and distributing large security issues, while New York houses frequently cooperate in distributing local issues.

The vast volume and wide variety of securities underwritten in New York have naturally led to the establishment there of many different sorts of security dealers. Some underwriting houses are members of the Stock Exchange and some are not. The inevitable process of specialization has induced some investment houses to limit their business mainly or even exclusively to securities of a single class, such as railroad or public utility or foreign securities.

**Function of the Security Underwriter.**—The underwriting security house is an invaluable part of the financial mechanism, since it enables the manufacturer to sell his entire block of securities and obtain his money at once. As a rule, as soon as the manufacturer turns over his securities to the underwriter and gets his money for them, he can go about his business with only a sentimental interest in the underwriter's further proceedings. The underwriting house thus assumes the risk, expense, and trouble of reselling to investors and speculators the securities it purchases, for the consideration of a profit between the purchase and selling price.<sup>3</sup> The purpose of the underwriting firm is not, of course, to invest its funds permanently in the new securities for the sake of their dividends or interest coupons, but rather to resell them at a profit. Its business is in consequence essentially speculative. Indeed, if the underwriting house cannot sell out its issues readily, and thus turn over its capital rapidly, it cannot profitably engage in the underwriting business at all.

Usually it has been true that real and ready investors in a new security are frequently rather difficult to find in a hurry, even by a firm of long experience and conspicuous energy and ability in that very business. For this reason, the task

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<sup>3</sup> Appendix IVb.



which the underwriting house faces in marketing the securities it purchases often involves hard work over a considerable period of time. If the issue underwritten is small, the underwriting firm may handle it alone without the assistance of other investment houses. But with a larger issue the underwriter will usually organize a syndicate, composed of several firms which agree to share the risks, profits, and expenses of marketing it with him.<sup>4</sup> The number of firms in such a syndicate depends upon the size of the issue to be sold, as well as the current economic condition of the market. The average syndicate consists of from three to five firms, all of which may or may not be located in New York. On the other hand, the record \$500,000,000 Anglo-French 5% loan floated under the leadership of J. P. Morgan & Co. in 1915, was handled by a huge syndicate comprising almost all the wholesale security houses in the country.

**Allotment of Syndicate "Participations."**—After the syndicate has been organized, the original underwriting house, as its organizer and manager, proceeds to arrange the "syndicate allotments" or "participations"—that is, the exact portion of the total security issue which each member of the syndicate agrees to purchase and attempt to resell. It is a significant fact that prior to 1914, while the United States was still on the whole a debtor nation, foreign financial houses participated largely in American syndicates. After the war, however, we became a creditor nation, and this former practice was reversed. At present the tendency is for this country to finance itself almost entirely and, in addition, to underwrite and distribute here the securities of foreign countries, occasionally with the assistance of foreign financial houses.

With the larger security issues, members of the syndicate often sell extensively to smaller distributing subsyndicate houses, which do a retail rather than a wholesale business in securities. The syndicate member may thus dispose of his

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<sup>4</sup> See "Money Trust Investigation," Vol. III, p. 1661.

allotment to such firms wholly or in part, at a slight profit to himself. The business of underwriting and selling securities is thus highly organized, and includes wholesalers, jobbers, and retailers.

**The Public Offering.**—The next step, after these preliminaries have been arranged, consists of the “public offering.” Under direction of the syndicate manager the new security issue is advertised for sale in the newspapers and magazines on a set date, and simultaneously syndicate and subsyndicate members release to their prospective customers circulars in which the essential facts relating to the new security are set forth. The price at which it is offered for public subscription is, of course, above the purchase price paid by the subsyndicates and still further above that paid by the syndicate to the issuing corporation. If, for example, the “subscription price” of a bond issue is 100, the price to the subsyndicate might be—say—97, and the price paid to the corporation 96. Such arrangements vary, of course, according to the size and attractiveness of the issue, the condition of the investment market at that time, and other factors.

It may be noted in passing that the public advertisements sometimes contain a statement that “Application will be made to list the above issue on the New York Stock Exchange.” This is especially true of the larger issues, which will presumably need a broad market later. Since the underwriting syndicate houses, if they are firms of standing, are thoroughly acquainted with the listing requirements of the Exchange, the supposition is that such an issue will probably fulfil these requirements and ultimately find an active market there. Certainly no good house would care to make such an announcement, were there much danger of being discredited in the eyes of the public by having the issue later refused the privilege of listing by the Exchange. Sometimes, too, the advertisement of a new issue contains at the bottom the statement that “All the above issue having been sold, this advertisement appears as

a matter of record only." This means simply that the syndicate, the names of whose members are printed beneath the advertisement, has sold out all its securities. But it does not mean that subsyndicate firms which may have bought them, have as yet resold them all to the public.

**Distribution Following the Offering.**—After the announcement to the public that the security is for sale, the syndicate members and subsyndicate firms endeavor to dispose of their respective allotments of the new security as rapidly as possible. The buyers "on the offering" might be divided into three chief classes: (1) pure investors, who subscribe to the security in order to hold it for the sake of the income to be derived from it; (2) speculative investors, who are willing to hold it for income but who hope to be able to sell it out at a profit to themselves sooner or later; and (3) speculators, who plan to resell it as quickly as possible for a slight profit.

The proportion of these several classes of buyers in the case of any given security depends primarily upon the nature of the security, as well as the condition of the market at that particular time. In the case of a small but very attractive and gilt-edged bond issue, investors might conceivably purchase the whole issue at once. But under most circumstances and with most securities, particularly if the issue is a large one, probably a considerable part will have to be sold to speculators. This is natural enough, for the conservative investor almost always demands "seasoned securities" and is apprehensive of those which are new and yet untried. Since, therefore, in most cases there is not sufficient investment demand to absorb the entire new offering at once, the speculator must be relied upon to absorb the surplus remaining in excess of this demand, at least for the time being.<sup>5</sup> Sometimes as much as 90% of a new issue of stock may rest in speculative hands and only 10% with investors, after the public offering has closed.

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<sup>5</sup> See Chapter II, p. 55.

**Further Preliminary Distribution.**—Often this preliminary distribution of a new security is not sufficiently stable and complete to meet the listing requirements of the Stock Exchange. In consequence, the new issue may undergo a further process of distribution on the New York Curb Market.<sup>6</sup> Although Stock Exchange houses often have representatives there, nevertheless the Curb Market is an organization completely separate from the Stock Exchange.

The chief economic function of the Curb is as a preliminary market; frequently it anticipates the termination and even the opening of a public offering of new securities, by allowing contracts for their purchase and sale to be made "when, as and if issued."

After a new security has been traded in upon the Curb for a period, its distribution may of course undergo further changes. The principal sellers there are: (1) members of the syndicate or sub syndicate (provided, of course, that their allotments have not already been sold out); (2) speculators who purchased on the public offering; and (3) speculators who wish to resell the securities also purchased there. The principal buyers are as before: (1) pure investors, (2) speculative investors, and (3) speculators "for the turn."

The chances are that a considerable proportion of the new issue may still remain in speculative hands. Nevertheless, the investment holdings usually tend to increase, provided, of course, that the security is of the sort which warrants purchase by investors. In this way a more stable and satisfactory preliminary distribution is attained. This is sometimes as far as the matter goes, either because the Stock Exchange authorities are unwilling to have the particular security listed on the latter market, or because the issuing company does not apply for such a listing.

**Part of the Stock Exchange in Distributing Process.**—Thus far the operation of the underwriting syndicate or sub-

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<sup>6</sup> See Appendix IVc.



syndicates in their mutual transactions, the subscription offering made to the public, and the transactions in the new security on the Curb, have not in any way involved the Stock Exchange. This fact is reiterated because of the vague idea which many people seem to have, that the Stock Exchange supervises all new security issues from their very inception. Nothing as a matter of fact could be further from the truth. The Stock Exchange begins to function in the distribution of any given security only when the latter is listed for trading on its floor.

Most large corporations, whose security issues aggregate large sums of money, naturally desire to list upon the Exchange in order to gain the advantage of its broad and reliable marketing facilities. But first a formal application must be made for listing by, or on behalf of, the corporation itself. The Stock Exchange never urges or solicits companies to list their securities upon it, lest it should appear to endorse them or give assurance in advance that they will be listed. Such applications for listing are referred to the Committee on Stock List,<sup>7</sup> whose function it is to receive and consider them, and either to take action upon them itself or to make recommendations concerning such action to the Governing Committee.

#### **Requirements for Listing on the Stock Exchange.—**

When application to list is first made, the applicant is given several separate documents, depending somewhat upon the particular kind of security for which the listing is being sought.<sup>8</sup> The most significant of these documents are the list of requirements, the questionnaire to be signed by an officer of the applicant company, and the distribution statement. Since the listing requirements are too extensive to permit of detailed comment here, they are reprinted complete as an appendix to this chapter.<sup>9</sup>

These requirements have resulted from many years' experience by the Stock Exchange governors, are varied according

<sup>7</sup> See Chapter XVI, p. 451, and also the Constitution of the New York Stock Exchange, Article X, Sec. 1, p. 25.

<sup>8</sup> See Appendix IVd.

<sup>9</sup> See Appendix IVe.



to classes and kinds of securities and enterprises, and are modified from time to time as new conditions warrant. In formulating them, the Committee on Stock List has had the benefit not only of its own knowledge of securities and securities markets, but also of the most expert advice in each case obtainable. Before composing its requirements for mining securities, for example, the Committee consulted the Metallurgical Society, whose suggestions are embodied in the present form. Similarly, in respect to the problem of listing petroleum securities, recourse was had to the American Institute of Mining Engineers. More recently, the Committee after similar investigation established certain special listing requirements for foreign government dollar bonds in 1925, for foreign internal shares in 1927, and for investment trust securities in 1929.

All applicants for listing must comply with these requirements which tend to become more exacting year after year. It must be remembered, however, that extensive corporate enterprise in many different industrial fields is still relatively new, and hence, what should constitute proper listing requirements for such securities has sometimes been a question to be decided on little practical evidence.

**Regulations Regarding Security Certificates.**—Certain requirements have to do with the form of the security certificates to be listed. They must be fully engraved and printed from at least two steel plates in a manner satisfactory to the Committee, and specified features of the issue must be clearly set forth on their face. The Exchange also requires that the work be done by an approved engraving company. When the capital sums into which such security issues frequently run is remembered, the need for the strictest measures to prevent forgeries or overissues of certificates is apparent. The same general problem with respect to American paper currency forced the United States government to organize its Bureau of Engraving and Printing.

By this strict supervision over the preparation of certificates

to be listed, the Exchange endeavors to prevent forged certificates from gaining circulation. "The part that the New York Stock Exchange plays in this regard," declared a financial expert of long experience in Wall Street,<sup>10</sup> "may be compared to the creation of the national banks and their notes of issue, after the era of wild cat private bank note currency." The prevention of forgery is, of course, basic to the ready negotiability which is so important and advantageous a characteristic of securities listed on the Exchange.

**Transfer and Registry Offices.**—Corporations which list their registered shares on the Exchange must maintain two separate offices or agencies in the Borough of Manhattan, City of New York—one for their transfer and the other for their registration. In some cases, the transfer offices are simply departments of the corporation, but often companies prefer to pay banks or trust companies to act for them in the capacity of transfer agent. But the registrar must always be some institution (such as a bank or trust company) completely independent of the corporation. Although the corporation pays for the services of the registrar, the latter is under binding agreements to the Stock Exchange, and will not register additional stock until the Committee on Stock List gives authority for it. Stock certificates listed on the Exchange are not valid until countersigned by the transfer agent and registered by the registrar, and thus the public is protected not only against security forgeries, but also against the secret overissuance of stock by an unscrupulous corporation.

Bearer securities naturally do not need transfer, but as a rule a registrar is required to authenticate them for the market.

**Responsibility of the Stock Exchange.**—The listing requirements also call for a statement from the company as to its corporate structure, its past earning record, its assets and liabilities, etc. The purpose of the requirements is to make avail-

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<sup>10</sup> Article by Duncan MacGregor in the *Financial Barometer*.

able to the investing public information which will be adequate for an investor to form his own opinion intelligently concerning the value of the securities. Naturally, the Stock Exchange cannot be responsible for the ultimate success or failure of the corporate enterprise in question, for after all, the Exchange is not running its business, but simply furnishing a market place for its securities. The fact that a given security is listed on the Stock Exchange is not and cannot be any guaranty of its value, nor does it even imply that the Exchange recommends it for the favorable consideration of speculators or investors.

During the war an exception to this rule was of course made in respect to Liberty bonds; these the Exchange heartily endorsed on patriotic grounds, and did its utmost to persuade investors to purchase them. Yet, from the purely investment standpoint, this advice was unfortunately not altogether happy, for these issues, which were generally and correctly termed "the soundest security in the world," ultimately caused large losses to a great many investors. This instance should suffice to show why the Exchange cannot undertake to endorse its listed securities. It does everything actually in its power, however, to safeguard the American investor, frequently regardless of the possible profits of its own members.<sup>11</sup>

**Insistence by the Stock Exchange upon Publicity.**—The New York Stock Exchange demands that corporations and foreign governments listing their securities upon it give the widest and most adequate possible publicity to their affairs. In the initial listing application, the applicant is called upon to reveal past earning power and revenue, and with corporations a thorough current balance sheet. In addition, the Exchange strives to obtain agreements from the applicant to publish balance sheets annually, and earning statements as frequently during the year as is possible, in order to keep the public record up-to-date.<sup>12</sup>

<sup>11</sup> See Appendix IVf.

<sup>12</sup> See Appendix IVg.

These agreements, along with other matters, are covered in the so-called listing "questionnaire" and related documents, the texts of which are reproduced in an appendix to this chapter.<sup>13</sup>

This demand by the Stock Exchange that corporations and foreign governments listing their securities upon it give wide and adequate publicity to their affairs, is made primarily on behalf of the public. The information received by the Committee on Stock List concerning any security which is listed is available to the public. The Committee in fact refuses to receive statements from a corporation which cannot be printed in the listing application, or be made accessible to its stockholders and to investors generally.

Corporations with securities listed on the Stock Exchange are also required, subsequent to listing, to make public at suitable intervals their earnings and other essential and current statistics. The Exchange requires the companies in question to publish such information in the press and thus make it readily available to people all over the world.

The Stock Exchange has and seeks no power over the corporations of the country. If it should attempt to set itself up as a self-appointed censor of all American business, the Exchange would invite and deserve public criticism. If its regulations with regard to listing should become excessive and inequitable, they would soon prove valueless, since the corporations would refuse to list their securities there. The Exchange can and does, however, employ moral suasion with the corporations of the country, and thus has been all along an important factor in the constantly rising standards of corporation ethics which are apparent in this country.

**The Test of Distribution.**—As to the questionnaire mentioned above, an examination of it as it appears in the accompanying appendix suffices to reveal its purpose. A further word is, however, necessary concerning the distribution statements which are reproduced on accompanying pages (Figures

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<sup>13</sup> See Appendix IVh.

4 and 5). Here the applicant for listing must state the number of shares held in blocks of different sizes, and also the number of shares held by the ten largest stockholders of record. It is

| _____ (Company)                                      |                         |          |
|------------------------------------------------------|-------------------------|----------|
| Date _____                                           |                         |          |
| Distribution of _____ Bonds on _____ 19              |                         |          |
| No. of Holders                                       | Holding                 | Amount   |
| _____                                                | up to \$5000            | \$ _____ |
| _____                                                | \$5001-10000            | \$ _____ |
| _____                                                | 10001-20000             | \$ _____ |
| _____                                                | 20001-30000             | \$ _____ |
| _____                                                | 30001-40000             | \$ _____ |
| _____                                                | 40001-50000             | \$ _____ |
| _____                                                | over 50000              | \$ _____ |
| _____                                                | Total number of holders | \$ _____ |
| (To be made out for each class of bonds applied for) |                         |          |

Figure 4. Bond Distribution Statement

To show distribution of a bond issue for which listing on the New York Stock Exchange is sought.

imperative for the establishment of a free and open market for the new security, that not too much stock shall be held in large blocks, or by too few shareholders. The Stock Exchange cares nothing about who the shareholders are, and in fact will not



|                                                                                  |              |                    |              |                    |
|----------------------------------------------------------------------------------|--------------|--------------------|--------------|--------------------|
| _____ Company                                                                    |              |                    |              |                    |
| Distribution of _____ Stock                                                      |              |                    |              |                    |
| on _____ 19__                                                                    |              |                    |              |                    |
|                                                                                  | Holders of   | 1 - 100 share lots | . .          | Shares             |
| _____                                                                            | "            | 101 - 200          | " "          | _____              |
| _____                                                                            | "            | 201 - 300          | " "          | _____              |
| _____                                                                            | "            | 301 - 400          | " "          | _____              |
| _____                                                                            | "            | 401 - 500          | " "          | _____              |
| _____                                                                            | "            | 501 - 1000         | " "          | _____              |
| _____                                                                            | "            | *1001 - up         | " "          | _____              |
| _____ Stockholders                                                               |              |                    |              | _____ Total Shares |
| * The ten highest holders on the above date were as follows:                     |              |                    |              |                    |
| 1                                                                                | _____ Shares | 6                  | _____ Shares |                    |
| 2                                                                                | _____ "      | 7                  | _____ "      |                    |
| 3                                                                                | _____ "      | 8                  | _____ "      |                    |
| 4                                                                                | _____ "      | 9                  | _____ "      |                    |
| 5                                                                                | _____ "      | 10                 | _____ "      |                    |
| _____ Total _____ Shares                                                         |              |                    |              |                    |
| All stock is free for sale and is held under no syndicate, agreement or control. |              |                    |              |                    |
| Certified Correct.                                                               |              |                    |              |                    |
| (To be made out for each class of stock applied for)                             |              |                    |              |                    |

Figure 5. Stock Distribution Statement

To show distribution of a stock issue for which listing on the New York Stock Exchange is sought.

receive a list of them, but it is keenly interested in the proportionate amount of the total issue which the largest of them holds. A stock is considered to be poorly distributed if a few shareholders own the bulk of it in large blocks, and well distributed if many shareholders own it in small lots. By means of the distribution statement, the Exchange gets an idea of how readily a free and open market can be created for a new security on the floor, and it thus minimizes the danger of corners or of large blocks being dumped suddenly on the market.

**The Routine with Applications to List.**—When the applicant has filed with the Stock Exchange the application meeting the listing requirements, and the other papers called for, including the questionnaire and distribution statements, the papers are gone over carefully; and after any necessary corrections have been made by the applicant, a date is set for a hearing upon them. At the time of its receipt the application is posted on the floor of the Exchange, so that members may familiarize themselves with the facts it sets forth, and communicate to the Committee any knowledge they may have concerning the enterprise.

The Committee on Stock List meets Mondays at 3:15 P.M. and carefully examines and considers any application which has been submitted to it. If it finds that the various requirements have been satisfactorily met by the applicant, it recommends to the Governing Committee that the application be granted. Usually, although by no means always, an application recommended by the Committee on Stock List will be favorably acted upon by the governors.

When the recommendation of the Committee on Stock List in the matter of an application to list securities is adopted by the Governing Committee, authority is granted for such listing of such securities. A notice is then prepared and sent over the tickers throughout the Wall Street district the next morning and trading in the securities on the floor of the Exchange

begins, unless some stipulated condition has still to be met before such trading can take place.

**The Creation of an Active Market.**—The “free and open market” maintained by the Stock Exchange demands, as is made clear in the distribution statement, that “all stock is free for sale and is held under no syndicate, agreement or control.” This requirement is, of course, designed to prevent blocks of the new issue being held off the market by a syndicate to maintain an unduly high price for it.

An underwriting syndicate invariably feels a keen responsibility for the market action of its newly listed security during its initial career on the Exchange. The syndicate members realize that the financial reputation of their respective firms is largely at stake over the success of the issue. But while there is a considerable element of self-interest in the syndicate’s attitude toward the initial career of its new issues on the Exchange, there is also a large ethical element involved. An integral part of the work of an underwriting syndicate is to see not only that its issues are initially distributed among investors and that other investors can at all times readily buy them, but also that such investors shall be protected by being able, if need be, to sell them with equal readiness. Now there is no inherent magic in listing on the Stock Exchange which can produce automatically an active and stable market in a new security as soon as trading in it is permitted. Active markets in any security result from many buyers and many sellers, and their stability depends in large measure upon the orders to sell above and buy below the current price, which stand on the brokers’ and dealers’ books.<sup>14</sup> But it takes time for the investing and speculating public to become enough interested in a security to buy and sell it in equal enough and constant enough volumes to create an active market for it. Moreover, when it is first listed there has been no opportunity as yet for the stabilizing orders “away from the market” to accumulate in dealers’ and spe-

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<sup>14</sup> See Chapter VIII, p. 225.

cialists' books. During this uncertain initial period of trading in a new issue, most underwriting houses consequently feel under the necessity of stimulating its activity and stabilizing its price.<sup>15</sup>

This they do by putting orders in the market to buy the new security "on a scale down," or sell it "on a scale up." A given syndicate manager, for example, might give orders to buy 1,000 shares of a given newly listed stock at 99, 1,000 shares at 98, at 97, and 96, respectively; together with orders to sell 1,000 shares at 101, 1,000 at 102, at 103, and 104, respectively. The giving of such orders in no way constitutes "matching orders,"<sup>16</sup> for the syndicate manager's buying and selling orders are fixed at such prices that they cannot meet, but simply make it possible to execute any buying and selling orders which may come into the market, at approximately 100.

By such operations any investor who wishes either to buy or sell the new security can be certain of being able to do so. In due course orders away from the market are sent in by investors and speculators, just as in the case of long-listed securities, and accumulate in the dealers' and specialists' books. Gradually, but as rapidly as they can, the syndicate members reduce the amounts of their "scale orders" until at length, the dangerous initial stage having been past, the new security is left to follow its own devices. It should be noted that this effort of the syndicate to provide an active market is not undertaken for the purpose of speculative profit; it tries to avoid heavy losses, of course, but usually incurs small ones by the operation. From the standpoint of the syndicate, it is an irksome, dangerous, and not inexpensive moral duty which it owes to its investors and to its own good name.

**The Question of "Scale Orders."**—The grounds for objection to this practice of employing scale orders are not so much that it stimulates the activity of trading in the new security,

<sup>15</sup> See Appendix IVi.

<sup>16</sup> See Chapter XVI, p. 455.

as that it may amount to a manipulation of prices at which sales are made. Scale orders cannot be used without fixing upon some one figure above which the syndicate will sell and below which it will purchase. This of course tends to confine the price approximately to this figure, since, if heavy selling orders come into the market, they will meet the syndicate's scale buying orders and thus prevent the price from declining severely, while heavy buying orders will similarly meet the syndicate's scale selling orders and prevent a sharp rise in price. If the figure around which the syndicate tends temporarily to confine the movement of prices is a fair one and in accord with the real value of the security, no economic harm is done. On the other hand, should the price set by the syndicate be higher than the inherent value of the security warrants, the possibility of causing ultimate losses to investors arises.

**Practical Power of Syndicates in the Market.**—But it must not be forgotten that the syndicate manager is, after all, dealing in a national market. He has given publicity to the essential details of the equity and earning power behind the new security. Sales of it made on the Exchange are instantly reported all over the country. Any disparity between price and value immediately makes speculative profits possible. If, therefore, he attempts to stabilize its price at a figure in excess of its inherent value, the new issue will at once become a target for speculators from every corner of the nation. Against the combined pressure which they can quickly exert, no syndicate could hope to hold its ground for any length of time.

In consequence of this irresistible and immediate corrective force which national speculation exerts, the power of syndicates to do harm by attempting to stabilize prices is reduced to a minimum, although it is not wholly eliminated. On the other hand, the stimulation of activity and stabilization of price is a temporary but inevitable practical necessity in the case of newly listed securities. In this connection, it is interesting to recall that in 1917 the United States Treasury Department, in coop-



eration with the Federal Reserve authorities and many patriotic security dealers in Wall Street, formed a syndicate to supervise the initial marketing of Liberty bonds. Whatever the theorist may allege—and there are theoretical objections to such operations unless they are skilfully and judiciously conducted—the Liberty bond syndicate was absolutely necessary to the successful distribution of the first and the later issues.

**The "Seasoning" of a New Security.**—The length of time during which underwriting syndicates maintain scale orders in the market to buy and sell a newly listed security varies considerably. It depends in the main upon the attractiveness of the issue and the general condition of the securities market at the time. But as soon as an active market has been created for it and there is promise that its prices will not be violently deflected by technical conditions in the market incident to its recent appearance there, the syndicate will gladly withdraw its buying and selling orders, and leave the new security to go its own gait unsupported and unassisted. In this way, the process of "seasoning" the new issue begins.

Pitiless publicity has already been turned upon the security. Investors and speculators from coast to coast study its merits and defects. Analytical articles are written upon it in the financial and the general press. Its sales on the Exchange are instantly flashed to the four corners of the United States. In consequence, the new security at once encounters what has well been called "the bloodless justice of the market place." Its prices will depend upon what the vast investing and speculating public of the whole nation thinks about it, and will fluctuate accordingly as these hundreds of thousands of people think better or think less of it.

Sometimes the result is gratifying to the underwriters and the original investors alike, and its price either holds firm or else advances. Sometimes, too, affairs do not turn out so pleasantly. If any inherent weakness develops in the security itself, or the government or corporation behind it, no senti-

mental regard is shown it on the Exchange. On the other hand, its genuine merits will usually be recognized there quickly and accurately.

This seasoning process is naturally of vast benefit to conservative investors. The latter can wait until a security is well seasoned and avoid losses due to any weakness in it which has been revealed, and benefit by the constant readjustment of the price accurately to fit the risk entailed by its ownership. Since this seasoning is performed in the main by the speculator, he thus renders at his own risk a real service to the conservative investor, without cost to the latter.<sup>17</sup>

**Speculative Maintenance of the Floating Supply.**—Meanwhile, of course, the same speculators do not as a rule hold the same stocks for long periods of time. Instead, there is a constant “churning” of the speculative floating supply of listed stocks in the market. Frequently, a given portion of a fairly speculative stock may be held in rapid succession by hundreds of different speculators before it becomes sufficiently seasoned to justify the investor’s purchasing it and locking it up permanently in his deposit box. But for all the swift changes of speculative ownership experienced by any one share of stock, the whole floating supply of the stock issue in question continues to be sustained at all times by all the speculators in the market, including the floor trader, the specialist, the odd-lot dealers, and the speculating customers of commission houses. Anyone can sell at any time at a concession in price, and no speculator or investor need be “stuck” with an unsalable certificate, as is so frequently the case with unlisted stocks.

**Striking Securities from the List.**—Occasionally, however, this process of seasoning and distributing a security upon the Stock Exchange will suffer a rude interruption, owing to the security being either suspended or stricken from the list by the Committee on Stock List. The conditions which commonly

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<sup>17</sup> See Chapter II, p. 55, and Chapter V, p. 128.

necessitate this drastic action, were clearly stated<sup>18</sup> by a former President of the Stock Exchange:

Our experience of many years as Governors of the Exchange, and the experience of previous Governing Committees, is that a small amount of stock in the list leads to a condition that is dangerous to ourselves and to our customers, the public; and therefore, in order to obviate the danger, when in our opinion that condition has been reached, we remove the stock from the list or suspend it from dealings. . . . The danger may arise from two causes. A small quantity of stock is more easily subject to manipulation than a large quantity, and by means of manipulation people may be induced to buy stock at very much greater prices than it is worth. The other danger, which of course is the greatest one we fear, is the subject of a corner in the stock, which not only hurts the broker and his customer, but demoralizes the whole country, the Northern Pacific corner being a case in point.

The Stock Exchange, therefore, is usually unwilling to list a very small security issue in the beginning. Moreover, it watches with particular attention, listed issues whose outstanding amounts have for any reason been considerably decreased. This sometimes happens when an issue of serial bonds has almost all been retired, or when in a reorganization some old stock issue has almost all been converted into a new security issue. The power to suspend dealings in any listed security, or to strike it from the list entirely, is and must from the nature of things be instantly exercised.

**The Problem of "Corners."**—It is particularly necessary when the free and open market for a security has been destroyed by the establishment of a "corner" in it that, for the protection of the public, trading in it should quickly be halted on the Exchange. Corners are more difficult of exact definition than might at first appear. A partial corner in a security may occur when a single individual or group of individuals gain possession of either a large majority or all of its floating supply. A complete corner arises from such an ownership of

<sup>18</sup> See testimony of H. K. Pomroy in "Money Trust Investigation," Vol. I, p. 494.

all or almost all of the outstanding amount of a given issue. When such a situation develops, anyone short of the security (and therefore under the necessity of purchasing it) is at the mercy of those holding the corner, who can either extort a premium from him on the stock he has borrowed to deliver to the original purchaser, or compel him to buy in his short stock at an exorbitant figure.<sup>19</sup> In the ordinary course of trading the possibility of a premium being charged on stock when borrowed, as well as that of its price rising, are in themselves strong safeguards against the creation of an excessive short interest. But when the remedy becomes more dangerous than the disease, it is the Stock Exchange's view of the matter that what was a slight and necessary economic readjustment becomes a deliberate and premeditated attempt at extortion by a few individuals, which is contrary to the just and equitable principles of trade. The Exchange accordingly acts to halt the offense by suspending dealings in the cornered security. The sensational interest attending corners is in itself a proof of their rarity on the Stock Exchange.

**Function of the Floating Supply.**<sup>20</sup>—Both prior and subsequent to the listing of a new issue upon the Exchange, a large part of it is often held by speculators who stand ready to sell out their holdings quickly, while the remaining portion of it is held by investors who desire to hold it for a longer period. The latter part of the issue is said to have been absorbed by investors, while the former part, held by speculators, is known as the "floating supply."

The floating supply of a security is the current surplus over investment demand. By making it easier for it to be carried by speculators, the Stock Exchange, as we have previously noted,<sup>21</sup> performs a most necessary economic service to the

<sup>19</sup> See Chapter VII, p. 194.

<sup>20</sup> The author made a full statistical study of this sort, based upon U. S. Steel statistics, in 1928; this was issued as a series of articles in the *New York Evening Post*, and subsequently republished by the Exchange in pamphlet form under the title of "The Distribution of Securities Through the Stock Market."

<sup>21</sup> See Chapter II, p. 55.

country. It is also this floating supply which lends negotiability to the security, since any investor can at any time add to it by sales or subtract from it by purchases.

**Time Needed to Complete Distribution.**—The size as well as the attractiveness of the particular security issue also does much to determine how long its distribution among investors will take. Naturally, other factors being equal, it takes longer to distribute a large issue than a small issue, simply because there is more of it. Distribution, as a rule, is effected most quickly in the case of a small and attractive bond issue, and most slowly in the case of a large issue of new and speculative common stock. Furthermore, the floating supply of the average bond, because of its greater certainty of income to investors, etc., is usually reduced to smaller proportions than that of the average stock. This is one reason why the bond market is as a rule less active than the stock market, and also why many listed bonds are harder to buy or sell quickly than most listed stocks.<sup>22</sup> The floating supply of bonds, as well as of stocks, however, will increase when some doubt springs up as to their value or price, and with a larger floating supply their market tends to become more active.

The relative size of a security issue's floating supply changes over long periods principally according to the success of the enterprise, and over short periods mainly according to its price movements.

As the stock of a successful company becomes "seasoned" over the course of years, there is a continued "secular" tendency for investors to acquire its shares from the speculating holders of the floating supply. Under such circumstances, and especially when attendant conditions are stable, the stock passes from a speculative into an investment stage as the floating supply decreases. Many years, however, may elapse before this process of distribution approaches relative completion and

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<sup>22</sup> See Chapter X, p. 255.



the floating supply is reduced to small proportions.<sup>23</sup> Over a considerable period, however, and in the case of successful and stable companies, the average 100-share lot, after an adventurous and speculative youth in brokers' boxes and call loan envelopes, slowly settles down into a calm and dignified old age in the deposit box of some private or institutional investor.

But over shorter periods, the relative size of the floating supply depends mainly on the price of the stock. When prices rise sharply, there is usually a tendency for investors to sell out to speculators, and consequently for the number of shares in the floating supply temporarily to increase; conversely, a swift price decline usually tends to incite purchasing by investors from speculators and a decrease in the number of shares in the floating supply of the given issue. Such changes in the floating supply of the stock market as a whole produce what is often referred to as the "technical condition of the market."<sup>24</sup> In general, it is fair to assert that the speculators, by holding the most shares at the periods of greatest risk, enable investors to buy and sell more conservatively at all times.<sup>25</sup> For assuming these unusual risks arising basically from the inherent vicissitudes of industry itself, speculators sometimes, although of course by no means always, obtain the unusual profits which the assumption of such risks justify.

**The Example of U. S. Steel Stocks.**—Definite statistical evidence relating to the distribution of given security issues as between speculators and investors is usually impossible to secure. The principal exception consists of the very significant statistics relating to its preferred and common stock issues, which the U. S. Steel Corporation has published regularly since 1904.<sup>26</sup> Both issues have been large enough to preclude any abnormal conditions in their distribution arising from any unusual speculative purpose or condition. The U. S. Steel Corporation has endeavored to distribute its stock to investors for

<sup>23</sup> See Appendix IVj.

<sup>24</sup> Appendix IVk.

<sup>25</sup> See Chapter II, p. 55.

<sup>26</sup> See Appendix IVl.

many years, during which the company has proved a conspicuous financial success. The quarterly reports published by the Corporation give the proportion of both its stock issues which stands respectively in brokers' and in individuals' names (Figure 6). While a little of the former may really represent investment, and some of the latter be held for speculative purposes, nevertheless in a general way it is fair to consider stock standing in a broker's name as part of the speculatively held floating supply, and that standing in the name of an individual as investment stock.<sup>27</sup>

On the basis of this assumption, a comparative examination of these quarterly reports of the U. S. Steel Corporation from 1909 to 1920 shows that on December 31, 1909, 66.41% (or about two-thirds) of the common stock was in the floating supply, and only 33.59% (or about one-third) held by investors. Six years later, on December 31, 1915, 49.80% (or about one-half) of the same issue was speculatively held, and 50.20% (or about one-half) held by investors. On December 31, 1929, 21.21% (or only about one-fifth) remained in the floating supply, and 78.79% (or almost four-fifths) had been absorbed by investors. This is a striking illustration of the tendency of a stock to shift from speculative to investors' hands as it becomes seasoned over a long period of time.

The more complete diminution of the floating supply of an investment security as contrasted with that occurring in a more speculative common stock is furthermore shown by the similar statistics relating to Steel preferred, which has long been considered by many to possess investment features comparable to those of the average bond. On December 31, 1909, 17.57% of this preferred issue constituted its floating supply; but by December 31, 1915, this had shrunk to 11.15%, and by December 31, 1929, to only 7.01%.

The short-term tendency of the floating supply to expand or contract in accordance with rises or declines in the price,

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<sup>27</sup> Appendix IVm.

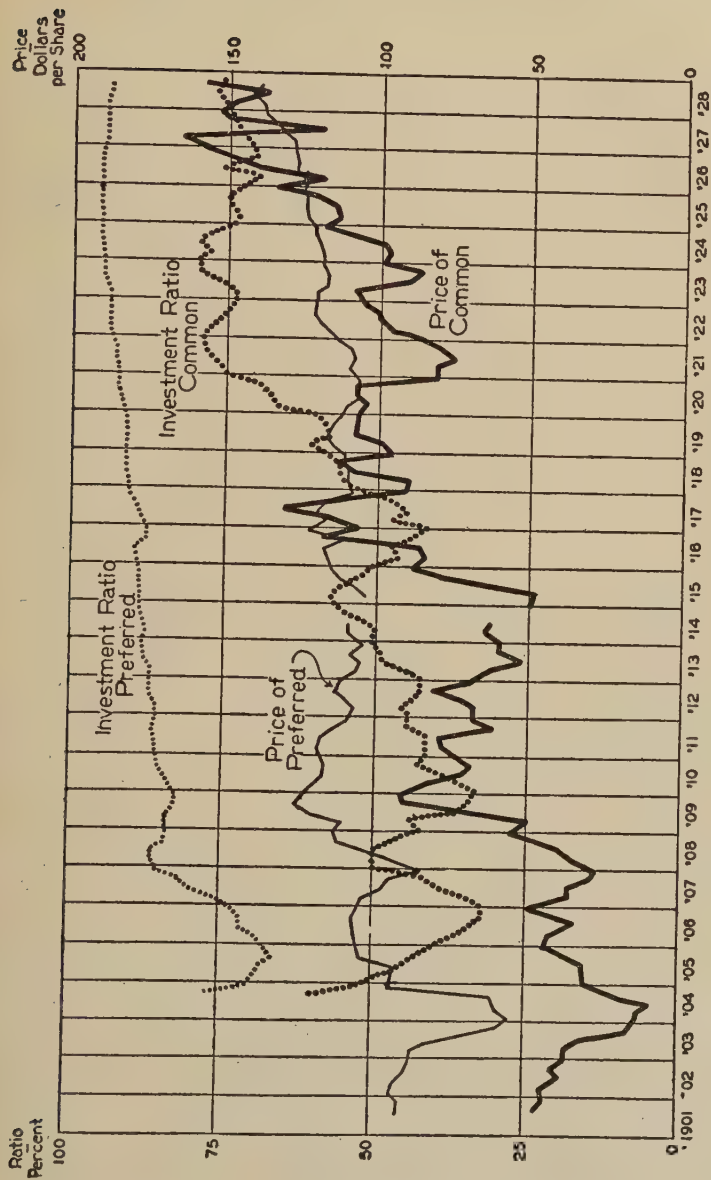


Figure 6. U. S. Steel Corporation Stock Distribution Chart

Showing prices of U. S. Steel preferred and common stocks, and percentages of each currently held by investors.

can also be clearly detected in the accompanying chart (Figure 6).

**The Floating Supply of Commodities.**—This necessity of gaining distribution by the intermediate aid of a speculatively held floating supply is nowise peculiar to securities. Few commodities or articles in the world today can normally be sold by producer to consumer as fast as production takes place. Whether in the wholesale cereal or textile commodities, or in manufactured products like automobiles and shoes, distribution inevitably involves a carrying process between the time when production is completed and the time when the final sale to the consumer is made. Since in this interval demand may slacken and prices fall, this carrying process which attends the sale of practically all classes of goods necessarily involves a speculative risk, and an accompanying chance for speculative profit.

In some cases goods are carried by several different types of speculative dealers, such as wholesalers, jobbers, and retailers, and reach the consumer only through the last class. All such dealers, since they attempt to make a profit by purchasing cheap and selling dear, are essentially speculators. Neither are they mere parasites. Without the stocks ready for sale which such dealers constantly carry at their own risk, most modern consumers could not even obtain food, clothing, and shelter for themselves, let alone any of those articles demanded by the refinements of modern civilization. Thus, the stock speculator who buys 100 Steel on margin trusting that its price will increase, is performing much the same service to society as the grocer who buys his canned goods on credit and in hopes of disposing of them at a profit. The higher degree of organization which characterizes securities markets, however, permits the stock dealer to enter into or conclude his transaction more easily.

**Slowness of Security Distribution.**—For several reasons the distributing process occurring in securities on the stock

exchanges is necessarily slower than in agricultural or industrial products. To begin with, securities, which from the investor's standpoint are simply the right or the assurance of receiving an income, are to the average man a luxury rather than an absolute necessity. All modern men must pay rent to obtain shelter, buy food in order to eat, and buy clothing to preserve their health. But they can get along without buying stocks or bonds. Hence, from the standpoint of the individual, the purchase of securities is made with surplus funds.

Since the tendencies in the stock market inevitably result from the actions of the hundreds of thousands who buy and sell securities in it, the factor of demand in the securities market is perforce more variable at different times and under different economic conditions than in the case of demand for commodities and articles absolutely necessary to the daily existence of mankind. In consequence, securities are on the whole harder to distribute among investors than most ordinary articles are among consumers, and from this fact it follows that the process of carrying the surplus of securities over investment demand in the speculatively held floating supply involves a greater proportion of many new stock issues, takes a longer period of time, and thus necessitates a more constant and considerable amount of financial speculation in them, than is the case with the similar carrying, from production to consumption, of temporary surpluses of other articles and commodities by speculative dealers.

**Listed Securities Always Salable.**—Moreover, it must be always remembered that unlike wheat, corn, and beef, which are destroyed through being eaten; or cotton, wool, and silk, which are destroyed by being worn out; or pig iron, bar copper, or lumber, whose immediate and more general usefulness is destroyed by being fabricated into special forms, shapes, and articles, securities are not thus destroyed or rendered unsalable in any way by their purchasers. The investor in stocks and bonds simply holds his purchased certificates in his deposit box,



in exactly the same form as when he received them. He is at liberty to sell them again at any time he wishes, and very often he does so. Thus, after being held for years by an investor, a given security certificate may readily be sold by him through the Stock Exchange to some speculator, and thereby added to the floating supply. In consequence, it is one thing to sell listed securities to investors, and another to keep them sold to investors.

Of course, some securities disappear in the course of time, either through the dissolution of the issuing corporation or through being paid off or converted into other securities. Nevertheless, there are bonds listed on the Stock Exchange which will not mature until after 2000 A.D., while stocks represent shares in corporations which in theory at least are deathless and perpetual. Furthermore, every year sees new and unseasoned securities created and listed on the Exchange. Thus speculation in any average security must be both extensive and of long duration, and distribution of securities necessarily demands considerable financing through the collateral loan market.<sup>28</sup> Funds thus employed perform in general the same economic service as funds employed by speculative dealers in effecting the distribution of any commodity or article to the consumer.

Professor H. C. Emery has epitomized this whole seasoning process experienced by listed securities in the following words:

Each new enterprise must stand the test of criticism, and unless unusually sound will be the subject of active speculation. Its ups and downs follow the changes of opinions, until gradually a continuous flow of dividends of moderate amount show the stability of real value (or lack of dividends shows the valuelessness) of the security and speculation ceases. The particular investment has been put through the ordeal and come out whole. It then becomes a field for the private investor. Many of the more active stocks of today may run their course and fall into the honorable obscurity of certainty.

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<sup>28</sup> See Chapter XI.

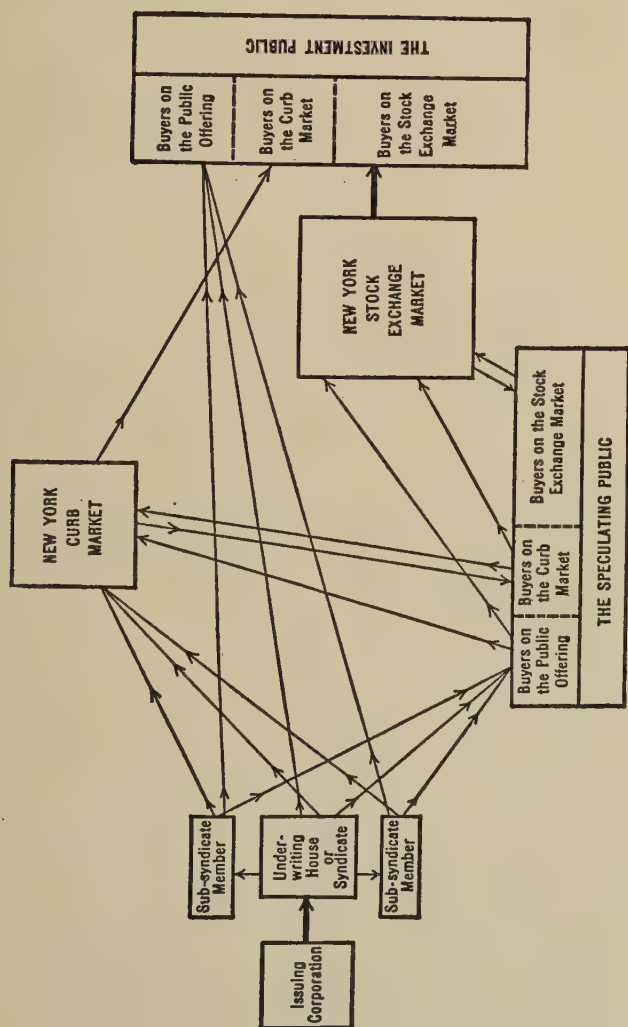


Figure 7. The Distribution of Listed Securities

Showing their course from the issuing corporation to the permanent investor. The flow of capital from investors into industry occurs in exactly the opposite direction in each instance to that here indicated.

**The Reciprocal Flow of Money into Industry.**—With respect to the whole process of distributing securities above outlined, the reader, of course, realizes that each time anyone disposes of stock he obtains money in exchange for it. The wider significance of this apparent platitude, however, deserves a further word of comment. The chart shown in Figure 7 illustrates the course of security distribution, beginning from the issuing corporation and ending with the permanent investor. But we must not forget the reciprocal flow of funds which this process of security distribution sets in motion, in precisely the opposite direction. The manufacturer gets his funds from the underwriting house, and frequently neither knows, understands, nor cares about the further stages of the process. The underwriters in turn sell the purchased security, perhaps at a profit and perhaps not, and obtain funds from the members of the subsyndicates and from speculative and investing buyers on the public offering, and perhaps on the Curb. The speculators to whom most of the security has been sold in turn shift it about among themselves, either for a profit or a loss, but, as we have seen, gradually sell out the floating supply, which they hold, to investors on the Stock Exchange and thus get their money back.

Disregarding minor exceptions, therefore, it can be said in general that underwriters cover their advances to the issuing corporation by cash receipts from speculators and investors, and that speculators as a whole cover their cash advances to the underwriters by cash receipts from investors on the Stock Exchange. In this process by which funds flow into industry, then, the Stock Exchange is an indirect but vital link. For the syndicate would not advance money to the corporation unless it thought it could get its money back, if not from investors then from speculators, and speculators in turn would be less willing to buy did they not think that they could sell out to investors in the long run. It is, of course, the Stock Exchange which enables investors over a period of years gradually to purchase

securities out of the speculative floating supply, and this is the real foundation of the whole process. Hence, it is quite correct to attribute mainly to the Stock Exchange the present continuous flow of large capital into industry,<sup>29</sup> even if manufacturers and investors are often unconscious of the fact and although a detailed explanation of the process such as the above is maddeningly reminiscent of "the house that Jack built."

**The Stock Exchange as a Capital Market.**—This function performed by the Stock Exchange in distributing capital to industry has been described by Charles A. Conant, the eminent banker and economist,<sup>30</sup> with the following suggestive simile:

The stock market acts as a reservoir and distributor of capital with something of the same efficiency with which a series of well-regulated locks and dams operates to equalize the irregular current of a river. The hand of man is being stretched out in the valley of the Nile to build great storage basins and locks, and the waters which flow down the great river may be husbanded until they are needed, when they are released in small but sufficient quantities to fertilize the country and tide over the periods of drought. Something of the same service is performed for accumulations of capital by the delicate series of reservoirs, sluice gates, and locks provided by the mechanism of the stock market. The rate of interest measures the rise and fall of the supply of capital, as the locks determine the ebb and flow of the life-giving water. The existence of negotiable securities is in the nature of a great reservoir, obviating the disastrous effects of demands which might drain away the supply of actual coin, and prevent the panic and disaster which, without such a safeguard, would frequently occur in the market for capital.

**Pre-War Importation of Investment Funds.**—Before the war it was generally recognized that the growth of security investing in the United States had not kept pace with the tremendously swift and enormous growth of corporate industrial enterprises here. In consequence, although even then we probably possessed more wealth and certainly were accumulating wealth more swiftly than any other nation in the world, we

<sup>29</sup> See Chapter II, p. 52.

<sup>30</sup> The Uses of Speculation, *Forum*, August, 1901.

nevertheless were unable to supply sufficient investment funds to finance our own trade and industry.<sup>81</sup> We had constantly to import for this purpose capital furnished by British, Dutch, German, and other foreign investors in our stocks and bonds.

During and since the Great War, however, this traditional condition was reversed and probably forever. Not only has large-scale American industry been financed by American security speculators and investors alone more adequately than ever before, but in addition our security buying class has for the first time become accustomed extensively to finance foreign governments and foreign business enterprises. Vast as have been the new security flotations in the United States since the war, there is little doubt but what the aggregate savings of our people have been at almost all times even more enormous.

**The New American Investing Public.**—During the war, thrift and the consequent creation of fresh capital was an imperative necessity. Brilliantly inculcated by the Federal Government and cooperating private financial institutions and firms, thrift was earnestly and patriotically practised by the rank and file of the American people with remarkable unanimity and success. The capital thus created flowed primarily, of course, into U. S. Government bonds.

After 1920, however, our National Debt ceased to expand and began rapidly to contract—a trend steadily maintained during succeeding years. But meanwhile, the unabated tendency of the public to save and invest poured forth each year a vast flood of fresh capital, which rising business prosperity only augmented. Billions of dollars consequently flowed into the important task of restoring Europe to economic health and financial equilibrium, and even larger sums were steadily made available for our own states, municipalities, and business enterprises. Even yet, the unparalleled extent of American savings, and the indispensable part they have played in saving Europe

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<sup>81</sup> See Chapter XVIII, p. 517.



from economic collapse and in stimulating and augmenting American prosperity, are little realized in this country.

Nor has security investment been confined to our older and wealthier states, or to the upper strata of American society. Practically everyone has begun to acquire and hold security investments, irrespective of who they are or where they live. The steady distribution of securities to employees has remarkably changed the relation of capital and labor in this country, and replaced a former spirit of mutual distrust by one of cooperating partners in business enterprise. The old demagogic expression of "bloated bondholder" seems to have become obsolete and to have disappeared altogether. Even the casual examination of the list of stockholders in an average listed American stock issue today will reveal the surprising extent to which shares are held in small amounts by investors all over this country. The radio has largely revolutionized security marketing in the United States by making daily Stock Exchange prices available to even the most remote localities. This whole American movement toward thrift and security investing is revealed by the enormous number of shareholders today in our larger American corporations.<sup>32</sup> It has been this ever-widening circle of American security investors which was basically responsible for the rapid growth of security dealings on the Stock Exchange after the war, and the consequent expansion of Stock Exchange facilities.

**The Menace of the Stock Swindler.**—The New York Stock Exchange, more than any major securities market in the world, has always striven to throw about the processes of dealing and investment in securities all the protecting safeguards which experience could indicate or ingenuity devise.<sup>33</sup> In recent years, this effort has been intensified because of the realization that so many of the new American investors were people of small means, brief financial experience and often imperfect

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<sup>32</sup> See Appendix IVn.

<sup>33</sup> See Appendix IVa.

financial contacts and sources of information. The collapse of the bucketshops in 1921-22<sup>84</sup> impelled such security buyers, often for the first time, to seek to do business through legitimate brokerage houses.

But an even more serious foe to sound security investment than bucketshops, has always been the irresponsible vendor of fraudulent securities. The frauds committed by both these varieties of financial wolves have not only injured unfortunate and helpless persons of small means, but have also tended to undermine the faith of the American people in legitimate security dealers, legitimate securities, and even in thrift itself. It has been small wonder that the victims of these iniquities, who frequently have known little about securities or the security business, should be inclined in their righteous wrath to lay the blame for their misfortunes upon the legitimate stock exchanges, reputable security firms and in fact upon everything and everybody connected with the security business in any way.

In recent years, however, the strenuous efforts made by the Stock Exchange to protect the public from the security swindler have borne fruit not only in rendering security swindling itself a more hazardous occupation, but also in a wider public understanding of the functions and character of the New York Stock Exchange itself and the facilities for protecting security investors which it maintains. In almost every direction are clear indications that the new American investors are becoming increasingly well-informed in these respects. After all, the bread and butter of Stock Exchange men consists in the interest and faith exhibited by the American people in buying listed securities. In a rather especial way, the New York Stock Exchange has long represented the otherwise inarticulate and inexperienced security investors, and its policies in this respect have been intensified and deepened from decade to decade, and even from year to year.

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<sup>84</sup> See Appendix IVo.

## CHAPTER V

### THE DANGERS AND BENEFITS OF STOCK SPECULATION

**Attitude of the Uninformed.**—The topic of speculation is an old and favorite theme with moralists as well as economists. Probably no factor in modern economic life is more frequently discussed, more generally condemned, and more rarely studied. Nor is this any new condition of affairs. Even the Middle Ages resounded with complaints against the “forestaller,” as the “bull operator” of that far day was commonly known. Something magic there is about the ten-letter word “speculator” today, which in a moment can make the average man exceedingly suspicious, although in most cases he could not to save himself explain clearly and from an economic standpoint just what speculation is or why it is so reprehensible. In his mind, too, the subject of speculation is often exclusively related to the Stock Exchange, in spite of the fact that speculation is a universal economic force and pervades all business. But perhaps he has heard of great fortunes gained or lost “on the Stock Exchange,” and, without endeavoring to ascertain the accuracy of his information in any way, he is left with the feeling that there must be something fundamentally wrong about any place or institution where such things can occur. The prejudice against speculation and speculators, although rarely based upon actual facts or economic knowledge, is nevertheless widespread and deeply rooted.

**Certain Undoubted Evils of Speculation.**—There is, of course, a genuine basis in both theory and practice for this perennial protest against speculation. Not even the stoutest defender of speculation, whether in securities or in anything

else, can declare it to be an unmixed blessing. But neither can the sincere but insufficiently informed critic afford to proclaim it to be a pure and unadulterated evil. And there is this difficulty about arriving at a fair conclusion regarding its comparative benefits and dangers, that the undoubted harm which it inflicts upon many speculators is very human, graphic, and easily described, while its economic benefits are abstract, indirect, and almost impossible to explain without the use of technical and unfamiliar words and expressions. It is natural, therefore, that our economists have rarely attempted any popular presentation of the subject, but instead have abandoned that field almost entirely to the editor who must get his paper to press without delay, and to the politically minded minor statesman. So long as the human race prefers watching motion pictures or reading fiction to struggling with the "dismal science" of economics, the harm of speculation will in the popular mind probably possess an emotional quality which even a thorough realization of its invaluable services to society never can have.

**Definitions.**<sup>1</sup>—Most of the erroneous notions concerning speculation arise from a vague or incorrect definition of the term. In this respect, even the best English dictionaries are of little help, since not only "speculation" but also "investment" and "gambling" are general terms, each with a variety of meanings. To some extent, too, they are used almost interchangeably.

It is obvious that if these words are to possess any exact economic meaning, stress must be placed upon the economic actions or deeds to which they refer. It is unfortunate that so many economists have gone no further in defining speculation than to refer to its derivation from the Latin *speculare*—to look at from afar—and to state that speculation consists in the intelligent attempt to deal with future uncertainties. It is more fruitful to see just what it is that the speculator actually does,

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<sup>1</sup> See Appendix Va.

rather than attempt to analyze his psychology. For everyone has to think about the future, whether he be a savings bank president or a mere wagerer on horse races or prize-fights. The degree of intelligence employed has little to do with the objective character of what is done. One might spend a lifetime studying race horses and make bets upon them with the greatest intelligence, and yet such money wagers would be completely different from purchases or sales of goods, even though these were made very stupidly. Indeed, few of this world's population—perhaps fortunately—are economists, and may sincerely think they are betting when in reality they are engaging in legitimate trade. Or the victim of a "bucketshop" may think he is purchasing shares, but if his supposed broker actually fails to purchase them, the thing which takes place is only a money wager, no matter what the deluded customer may think about it.

There are really three distinct processes which are usually referred to as "investment," "speculation," and "gambling" for want of more exact and mutually exclusive terms. The first—"investment"—consists in the placing of capital into some form wherefrom an income is expected; "speculation"—the second process—occurs when some property is dealt in with the hope of gaining a difference between buying and selling prices; lastly, the third process—or "gambling"—amounts to staking money or goods on some fortuitous event. Forgetting for a moment the inexact labels which language has struck upon these three courses of action, it is obvious that each of these processes genuinely differs from the other. The man who buys Steel shares in order to get the dividends which they will pay, is clearly doing something quite different from one who buys and sells Steel shares in order to secure for himself a profitable difference between buying and selling prices. It is still more apparent that a third person who does not buy or sell Steel shares at all, but merely stakes \$10 that they will rise or fall in price is performing an even more different act. From



the economic standpoint, it is essential in each case to concentrate on what kind of an act is committed, rather than what the one who does it may be thinking about at the time, or whether he is intelligent or the reverse, or indeed whether he is really a nice man in other respects or not.

**Distinctions Between Investment and Speculation.**—The theoretical distinction between investment and speculation in securities is thus clear enough. Yet in actual daily life this distinction becomes almost impossible to establish, owing to the usually inextricable connection between income and profits in securities. Of course, some cases of almost pure investing and of almost pure speculating exist. A savings bank account is an almost completely non-speculative investment, for there is no chance for appreciation of principal, but simply an income derived from it. Yet even here the failure of the bank or currency troubles might enter into the case. So, too, the purchase of a non-dividend-paying stock in order to profit from a possible rise in its price is almost a pure speculation; nevertheless, the rise in price will probably be due to an actual dividend or the hope of a declaration of a dividend upon it.

As a matter of fact, the purest cases of speculation occur, not in securities but in commodities, which do not of course pay interest or dividends, and hence do not involve this element of income which so extensively pervades the consideration of securities. In the field of articles and commodities the prototype of the investor is the consumer or user, and the distinction between speculation and investment consumption there depends upon whether the individual purchases goods to use or consume himself, or to sell to some other consumer with an attempt to get a profit. In the latter case he is just as truly a speculator as the margin purchaser of stocks or the short seller of cotton futures.

Returning to the instance of securities, however, the average man who buys 100 shares of stock wants both an income and a profit to be derived by selling it at a higher price later on,

and is therefore part speculator and part investor. Conversely, the practical speculator bases his purchases and sales of securities upon prices which are fundamentally determined by the income or the expectation of income to be derived from them. The margin purchaser, who is in the main a speculator, often selects dividend-paying stocks in order to offset his interest charges,<sup>2</sup> while the short seller gives careful attention to the dividends paid on his short stock, since he must pay them to the loaner of the stock. Moreover, many an investor who purchases for income will, after a swift rise in price, sell out for a profit and consequently become a speculator. Thus, in actual practice, the difference between investors and speculators in securities is one of degree rather than of kind, and it is especially difficult to state in any given case just where the one ceases and the other begins. It should be noticed that investment and speculation are alike in that they both involve a genuine exchange of ownership of actual property. All orders, whether for investment or speculation, are executed and cleared in exactly the same way in the Stock Exchange.

**Meaning of the Term "Investment Transaction."**—The ordinary Wall Street expression of "investment transaction" refers to an outright purchase and sale of securities, and that of "speculative transaction" to a margin purchase or short sale.<sup>3</sup> Usually, of course, margin purchasers and short sellers are actuated principally by a desire for profits rather than for income, and the presumption usually is when a security is bought or sold without the use of credit that the primary motive is income. Yet investors sometimes purchase securities on margin by the "part payment plan"; sometimes short sales are caused by the liquidation of investments from out of town or from abroad; and many people purchase securities outright in order to sell them later at a higher price. As working definitions, then, these expressions, while of considerable practical

<sup>2</sup> See Chapter VII, p. 182.

<sup>3</sup> It was with this meaning that Chapter VI, dealing with an outright purchase and sale, is entitled "A Typical Investment Transaction."

value in the daily work of the "Street," are nevertheless too superficial and mechanical to penetrate to the bottom of the matter.

**Distinction Between Speculation and Gambling.**—Coming now to the equally important distinction between speculation and gambling, this is not only clear in theory but, despite a few technical details, also quite clear in practice. There are at least four principal differences between speculation and gambling:

1. Speculation necessarily involves the purchase or sale of some form of property, while gambling does not.

2. The risks assumed by the speculator arise fundamentally from risks inherent in the property which he buys or sells, while the risks of gambling are created by the gambler and are based upon future events without any necessary relation to ownership of property.

3. The speculator's buying or selling operations affect the forces of supply and demand, and tend to bring about the very change in price for which he hopes, while the bets placed by the gambler have no effect whatsoever in determining the actual outcome of the fortuitous events upon which he stakes his money. In other words, a speculator who purchases 100 shares of Northern Pacific because he anticipates a rise in its price, assists by this very purchase in bringing about the rising market for which he hopes, while a gambler who bets \$10 that it will rain next Thursday, or that Yale will win the Harvard football game, exerts absolutely no effect upon atmospheric conditions, and in no way strengthens the sinews of the team of his preference.

4. In gambling transactions the winner makes what the loser loses. But in speculation, in the alternate rise and fall of prices, there are occasions where practically everyone profits, and where practically everyone incurs losses. Gambling has no economic justification, except when it is organized as insurance. But speculation is a profoundly necessary economic force.

**Superficial Resemblances.**—Speculation and gambling, of course, sometimes possess superficial resemblances. The motive for both may alike consist in a rash and unintelligent willingness to take large risks for large possible profits. A man can, of course, lose just as much money in unwise speculation as he can by “playing the races,” yet it does not follow that a stock market is a race-course. It is also true that some speculators use no more intelligence in purchasing or selling securities than as if they were blindly gambling upon an undeterminable future event. One worthy citizen is said to have taken a “long position” on certain speculative securities in a “bear market” because of the advice of a medium, who claimed to evoke the spirits of great American financiers. Extraordinarily enough, he was not inclined to blame the Stock Exchange for his losses afterwards.

Yet just such episodes as this raise the query why the Exchange should be visited with righteous wrath because speculators lose money through unwise ventures, when the similar lack of intelligence in other speculative lines of business evokes no such bitterness. A large proportion of all business enterprises undertaken in this country ultimately result in failure, and undoubtedly the cause is mainly ignorance and folly on the part of the management. America, too, has its share of poorly trained, inefficient business men who speculate with their savings and inheritances in poor real estate, impossible retail shops, and all manner of harebrained and unlikely enterprises every year, which soon exhaust their funds and leave them bankrupt. But they have no target later to direct their resentment against, while the losing speculator in securities can always blame the Stock Exchange for his own folly.

**Gambling Forbidden on the Stock Exchange.**—It is one of the principal services of the Stock Exchange to maintain a speculative market for speculative securities. But any form of gambling on the Exchange floor has long been prohibited. Its Rules (Chapter XIV, Sections 6 and 7) forbid “offers on the

Exchange to buy or sell dividends or to bet upon the course of the market." Furthermore, "Public announcement by a Stock Exchange firm or one of its members regarding moneys held for the purpose of betting on elections or on any other matters is prohibited."

Unlike the Stock Exchanges of London, Paris, Berlin, and other great financial centers, the New York Stock Exchange even forbids optional contracts ("puts," "calls," etc.) on its floor, on the grounds that when such contracts are not actually exercised, they might be construed as wagering on the course of prices, despite their value as a means of insurance. It is therefore only common justice to declare that, as far as the Stock Exchange is concerned such phrases as "stock gambler" or "gambling in stocks," when not a deliberate and conscious perversion of the truth, can arise only from the fullness of economic ignorance.

**Economic Function of Speculation.**—One vital economic service of market speculation consists in the assumption of those necessary risks which always exist during the process of distributing any kind of property. So fundamental an economic factor as speculation inevitably pervades every type of market and not simply the organized markets. The corner grocer who buys 100 pounds of sugar at 8 cents to distribute among his customers at 10 cents is essentially a speculative dealer. He has no intention of consuming himself all this sugar, but buys it with the hope of profiting by selling it at a price above its purchase price. This profit is earned because of the services which he renders in distributing the sugar, and is justified because of the risk which he assumes in holding it himself ready for sale. If the price of sugar declines below the purchasing price before the grocer has sold out his stock, he may of course incur a loss on his inherently speculative dealings in it.

The economic functions of the speculative dealer in Stock Exchange securities are in their main features identical with



the dealer in sugar. Like the latter, the stock speculator buys and sells at his own risk with the aim of making a profit, and plays a similar part in distributing securities among investors.

The fact that the stock market, because of the nature of the property in which it deals, must necessarily serve as a market for resales, does not alter this function of the speculator as a security distributor.

**Economic Education and Progress.**—Unfortunately, however, the economic education of the public has been very slow, while the evolution of our organized markets, particularly during the past half-century, has been extraordinarily swift. The paradoxical result is that the general public, although living by means of the economic institutions of today, frequently thinks in terms of an economic America which no longer exists. This is particularly true in respect to the whole general subject of distribution.

In consequence, the public is only too apt to mistake superficial and incidental differences between the modern organized exchange and the older and more familiar unorganized type of market for fundamental and basic differences, and to criticize and suspect the former because it does not conform in the details of its operation to the methods customary in the latter. Thus, through ignorance or misunderstanding of the system for clearing contracts in vogue in all the modern exchanges, some appear to think that speculation for small profits which is accompanied by a frequent clearance of intermediate contracts,<sup>4</sup> amounts to gambling, because there is no precedent for such a practice in the older unorganized markets.

Speculation in securities on the Stock Exchange of today, therefore, must be judged by its conformity in fundamental economic principle rather than in technical mode of operation, with speculation in other and less highly organized markets. Moreover, the actual *modus operandi* of the present Stock Exchange must be carefully studied before any intelligent con-

<sup>4</sup> See Chapter VIII, p. 205.

clusion can be drawn regarding either the benefits or the dangers of speculation there.

**Stock Speculation and Trade Depressions.**—Concerning the harmful results of stock speculation, we must first disabuse our minds of a few hoary fallacies, for speculation in securities has serious enough faults without attributing to it many others for which in fact it is not responsible.

The first of these fallacies is that stock speculation causes trade depressions. Whenever a recession in business occurs, the man in the street at once and quite naturally begins to look around for its cause. Without trying to analyze the basic causes of the trouble, he may recall that a few months before, when the sky was apparently unclouded and serene, the stock market had experienced a decline in prices. At once a hundred myths and legends he has heard about "Wall Street" spring up in his mind. And since the disturbance first became conspicuous on the Stock Exchange, he leaps to the conclusion that somehow or other speculation in stocks must have started it all.

This is the type of fallacious reasoning which centuries ago the philosophers called *post hoc ergo propter hoc*. For<sup>5</sup> the organized securities markets often reflect in advance, like a barometer, future developments in the field of business. Particularly in the highly organized and sensitive Stock Exchange, coming events cast their shadows before, and accordingly stock prices begin their adjustment to the future diminished net earnings and dividend rates which oftentimes general business is not equally quick in foreseeing. Thus it is really business recessions which cause serious stock market crises, rather than declines in security prices which bring on trade depressions.

It cannot, of course, be maintained that trade depressions are made any better because of preceding stock market troubles. Losses by security speculators to some extent curtail consumption, particularly of luxuries, temporarily make new financing more difficult, and spread a pessimistic spirit among business.

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<sup>5</sup> See Chapter II, p. 56.

Yet stock market profits usually are kept in the market rather than realized and employed for purchasing elsewhere. Also, financing before a stock market boom is apt to have been so extensive as to provide most of the capital which industry will require for some time, and in any case after a major liquidation of the stock market, funds soon become both cheap and abundant. Finally, the gloomy attitude sometimes engendered among business men by stock market crises, is frequently exaggerated and will depart as speedily as it has arisen; in any case, the stock market, as far as it does influence business through psychology, is ordinarily a stimulating rather than a depressing factor.

Actually, the serious depressions which have befallen American business have arisen from over-production and usually over-high commodity prices, and large commercial inventories. The mercantile markets are not as highly organized as the Stock Exchange, nor can they as readily or quickly adjust themselves to over-production. Speculation in most raw or manufactured products or in real estate is much more dangerous than speculation in securities, both because readjustment takes so long to effect, and also because the public standards of living are directly affected by it.

In many trade depressions, after the preliminary crash caused in the stock market, there has occurred a second Stock Exchange crisis when the illiquidity and depressed prices of other forms of property have driven business men to liquidate securities. Here the Stock Exchange, by functioning as a shock absorber to the national credit structure,<sup>6</sup> unquestionably performs a national service in counteracting the effects of commercial and industrial distress.

**Absorption of Credit.**—The charge is also frequently made that speculation on the Stock Exchange absorbs undue amounts of credit, and that money needed for the production of goods is, on account of speculative activities on the Exchange,

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<sup>6</sup> See Chapter II, p. 55.

diverted into collateral loans made for speculative purposes, which serve no useful economic purpose.

Naturally, in an active period on the Exchange, when speculation is comparatively heavy and prices are high, more money is borrowed on collateral loans than in a dull period when speculation is comparatively light and prices are low. But usually the same thing may be said of practically all other commodities. In the old-fashioned economic cycle which resulted in a money stringency, heavy speculation on the Stock Exchange has usually been only the first wave of a vast tide of speculation which sweeps through all markets, and which soon produces rising prices and extensive one-sided speculation in the unorganized markets. Such great speculative impulses are imparted to business by profound economic world forces which the Stock Exchange could not possibly either evoke or terminate. But at the first suggestion of an actual impending shortage of money, the securities market at once begins almost automatically to put its house in order to meet it. Prices on the Stock Exchange decline and collateral loans invariably experience a marked decrease, long before the crisis arrives.<sup>7</sup> Meanwhile, however, the speculative "boom" in the unorganized markets continues. Greater and greater sums of bank credit become tied up in loans on farm land, real estate, illiquid raw materials, and general merchandise. At a time when Stock Exchange loans are dwindling in number and total amounts, loans for the speculative carrying of commodities for which no organized markets exist, increase rapidly—and then the crash comes. This was plainly the case in the crisis of 1919–20.

The crisis of 1929 was comparatively unique in that it was not attended by any actual and necessary shortage of credit. But the ensuing crash in commodity prices proved very disillusioning to those who had thought that these had been mysteriously stabilized by credit control and the new technique of low commercial inventories.<sup>8</sup>

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<sup>7</sup> See Appendix XI.

<sup>8</sup> See Chapter III, p. 75.



Collateral loans do not materially strain our money market because the money which flows into call loans arises from surplus banking funds.<sup>9</sup> This tends, of course, to restrict the amount of such loans, as the high call rates for money frequently indicate. Moreover, collateral loans are in a practical way often undesirable to lenders, since they cannot be rediscounted at Federal Reserve banks.<sup>10</sup> When, therefore, we get a proper and full perspective of security collateral loans in their relation to other loans, we cannot help realizing that they cannot be held responsible for serious credit shortages. Neither are collateral loans an economic waste, but a very necessary financial operation in behalf of the indispensable and necessary work which the stock speculator performs for business and society.<sup>11</sup>

**Effect of Speculation upon Prices.**—Another charge is frequently made against speculation in securities—that it “unsettles prices.”<sup>12</sup> The fundamental cause for changing prices is, of course, changing values. In a market where values never changed there would never be any speculation. The more speculative character of the stock than the bond market is due to the fundamental fact that as a rule the value of bonds is less subject to change than the value of stocks. Speculation merely intervenes to adjust present prices to future but seemingly probable values. In this discounting of future conditions which results from speculation in stocks, we have seen that Stock Exchange price changes in the past have anticipated future changes in values. Naturally, such prophetic price changes are affected by human fallibility. Everyone, of course, knows that at the climax of a “bull market” prices for a time rise above what eventually turn out to be future values, and similarly at the end of a decline in the market, prices get below future values. Yet such conditions are only temporary, and it is

<sup>9</sup> See Chapter XI, p. 301.

<sup>10</sup> See Chapter XI, p. 278.

<sup>11</sup> See Chapters IV, p. 105, and XI, p. 302.

<sup>12</sup> See Appendix Vb.



speculation which subsequently readjusts the prices to inherent values.

Moreover, hindsight is always easier than foresight. It is easy to detect afterwards occasions when market prices, which largely represent human opinion, temporarily misjudged the trend in values, but it is a very different matter to stare into an inscrutable future and accurately fit prices to future values. The distance into the future which present prices may be discounting is also a variable factor. But with all due allowance for such exceptions, the general effect of speculation, if allowed freedom and permitted to proceed with equal ease for the rise or for the decline, is to stabilize prices,<sup>13</sup> by adjusting them even in advance of changes in intrinsic values.

Another public misconception of speculation seems to arise from a tendency to associate it with manipulation of prices. As a previous chapter<sup>14</sup> has pointed out, in reality free speculation is the principal corrective of the manipulation of prices.

**Losses from Speculative Ventures.**—After this extended account of the ills for which speculation is not responsible, the reader may think that the present study is an attempt to “white-wash” speculation. This is far from the truth. For, having disposed of these incorrect notions concerning speculation, there still remains a residuum of possible danger and harm to the individual which no one would attempt to deny—least of all members of the Stock Exchange, who, if only from their own experience, appreciate just how dangerous speculation can be.

This story of the real injury done by injudicious speculation is older than the South Sea Bubble and as universal as trade itself. For generations men have rashly undertaken speculative commitments in the stock market and out of it, have recklessly traded beyond their means, have been influenced in their commitments by “tips” and jumbled, absurd reasoning—and have lost their money. Usually, despite the

<sup>13</sup> See Chapter II, p. 45.

<sup>14</sup> *Ibid.*, p. 49.

fiction-writers, speculative losses in securities simply deprive the individual of a part of his surplus funds, just as financial losses arising from business or investments do. Yet such losses only too often cause hardships, not merely to the speculators themselves, but to their families and dependents, for whose sake, perhaps, they mistakenly engaged in the risks of speculation with inadequate knowledge of securities, of business, or of those vast economic factors which shape prices in all the markets of the world. Such losses by people who can ill afford them are the real source of the considerable public prejudice against speculation and stock exchanges, and indeed are profoundly human and moving to any man who has been long in Wall Street.

Furthermore, speculation is only too apt to distract the ordinary business man from his regular work. He becomes possessed of "an impatience to be rich, a contempt for those slow but sure gains which are the proper reward of industry, patience, and thrift."<sup>15</sup> If he has a weak and vacillating character, he is always fidgeting to finger a ticker tape. Often he is utterly ignorant of the economic currents and cross-currents to which he is so blithely entrusting his funds. In fact, he is apt to be the first to deny the significance of economic laws and principles as they affect security prices, and declare cynically that "It's all a gamble, anyway." Or else he will assume an owl's wisdom and discourse, with the jargon of "the Street," on a nondescript lot of economic fallacies and platitudes. It is this type of individual who almost always loses his money in the end.

**Speculation Impossible to "Abolish."**—Because of the all too frequent losses which men suffer by overtrading which they cannot afford, and also because of the deteriorating effect of speculation on weak and shallow natures, many honest and sincere, but short-sighted and hasty, people rush to the conclusion that speculation and speculative markets should be

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<sup>15</sup> Macaulay, "History of England," Ch. XIX.

abolished. Just as the king in the old play cried, "Off with his head! So much for Buckingham!" so, too, these people seize upon the seemingly simple expedient of curing headaches with the guillotine. But in spite of laws, in spite of threats, penalties, and restrictions, made in many lands by many peoples over the course of many centuries, speculation and speculative markets have stubbornly endured. The attempt at their abolition has invariably failed. As recently as 1896 the German government attempted to do away with speculation in securities and commodities.<sup>16</sup> Yet in spite of the characteristic Teutonic thoroughness, in spite of the despotic powers of the Prussian state, this attempt not only failed of adequate enforcement to such an extent that its regulations came to border on farce and absurdity, but it directly resulted in crippling the Berlin financial markets so thoroughly that when the law was repealed in 1909, their power had largely passed to London, Amsterdam, and Paris.

Most anti-speculation legislation has attempted to forbid speculation in certain forms of property, or to prevent certain classes of people from speculating, or to prohibit certain methods by which speculation is ordinarily conducted. But invariably experience has shown that the former two courses were arbitrary and inconsistent, while the last course was superficial and futile.

Perhaps the most thoroughgoing attempt to abolish speculation has been made in Bolshevik Russia. The ingenuous but fanatical theorist Lenin at first ordered traders and dealers lined against the wall and shot. Yet speculative trading went on, at extortionate prices and with unwholesome economic consequences. And instead of the glittering Utopia which this theorist and his confederates expected to establish, what actually followed? Russian industry collapsed, unemployment spread. In the cities starvation and the plague wrought a havoc unparalleled since the Thirty Years' War, until city life itself

<sup>16</sup> See Emery, "Regulation of the Stock Exchange," p. 822.

became all but impossible there. It is typical of all such attempts to abolish speculation that afterwards Lenin was forced to reinstate private speculative trading in fact, however much he continued to condemn it in theory.

Other more intelligent critics, who realize the inevitable existence of speculation, have frequently taken the Stock Exchange to task for the way speculation is conducted by brokers' customers. Especially the amount of margin required by Stock Exchange houses<sup>17</sup> has been attacked, since so many cases of loss to customers can be traced to buying stocks on small margins. Often, it is demanded<sup>18</sup> that the Stock Exchange compel everyone to trade on a given fixed margin.

**Stock Exchange Attitude Toward Margins.**—The members of the Stock Exchange must not for a moment be thought of as desiring to see their margin customers lose money. It must be remembered that the commission broker, through whom the public comes in contact with the Exchange, is not a dealer but a broker, and the agent of his customer. Far from making what his customers lose (like a croupier or other kind of gambler) the broker can derive no possible benefit from his customers' losses. On the other hand, these can frequently do him no little harm. For one perfectly selfish reason, he loses the account of that customer and the future commissions it might otherwise bring him. Between the hundreds of Exchange commission houses there is a keen competition for accounts.

Moreover, the broker may himself become involved in his customer's catastrophe, by attempting to "carry him" after his margin is exhausted. Failures of brokerage houses have often been due to such overextension of credit to customers, who may be unable or simply unwilling to respond to margin calls. And the failure of a Stock Exchange firm may entail losses,

<sup>17</sup> See Chapter VII, p. 184.

<sup>18</sup> "We urge upon all brokers to discourage speculation upon small margins, and upon the Exchange to use its influence, and if necessary its power, to prevent members from soliciting and generally accepting business on a less margin than 20%." (Hughes Report, 1909, in Van Antwerp, p. 420.)



not only to its customers but also to the other houses with whom it has concluded contracts on the Exchange. Even if the customer escapes with a slight loss, he is apt to blame his misfortune on his broker, whose goodwill suffers thereby.

The Stock Exchange takes what precautions it can to protect margin customers against loss. It enables the margin purchaser to place a stop-loss order in the market to limit a possible loss. It exercises great care in the securities which are listed in its market. Furthermore, it expressly provides in its Rules (Chapter XII, Sec. 1) :

The acceptance and carrying of an account for a customer, whether a member or a non-member, without proper and adequate margin may constitute an act detrimental to the interest and welfare of the Exchange.

If, then, the Stock Exchange has not hitherto adopted a flat minimum amount of margin, it is not because its members do not wish to see reckless dealing prevented, but because such an inflexible margin rule would prove impractical and useless. For one thing, as the chairman of the Hughes Commission pointed out,<sup>19</sup> "the right of one private person to extend credit to another is simply the right to make a contract, which, under the Federal Constitution, cannot be impaired by any State Legislature." Moreover, such a uniform and absolute requirement regarding margin would make no allowance either for the personal nature of all credit, or the vast difference between the price movements of different securities. Most Exchange houses would willingly execute orders from well-known customers on smaller margins than they would accept from a stranger. Similarly, there are many bonds and some preferred stocks which could be purchased with relative safety on a slight margin, while other securities, particularly high-priced common stocks, would be a riskier purchase on a 50-point margin.

The "questionnaire" system adopted by the Exchange in 1922, compelled member firms to possess capital adequate to

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<sup>19</sup> See Horace White, "The Hughes Investigation," *Journal of Political Economy*, October, 1909, p. 357.



their commitments, and thus led them to require higher margins from customers. The plenitude of business also tended to favor higher margin requirements, since it reduced the element of intense competition between brokerage firms which formerly led to keeping margin requirements at a minimum. The average margin requirements of Stock Exchange firms have been very much higher recently than ever before, and unquestionably this has materially strengthened the whole brokerage business.

The relatively high margins required by brokers before the panic of 1929, while they can scarcely be said to have effectually prevented intense public speculation, did operate to prevent the panic from becoming even worse than it was. Moreover, one of the most salutary steps taken by banks and Exchange houses during the crisis, was the lowering of margin requirements on security loans and customers' accounts respectively. If there had been some law requiring an inflexible minimum margin, it might not have been possible to take such a step. Respecting margins, no formula can ever take the place of wise administration.<sup>20</sup>

**Inevitable Risks of Business Enterprise.**—Speculation is fundamental to our present economic order of society and business, because it arises from the inevitable risks and the inherent vicissitudes of all industry and trade. Of course that extremely knowing class of people who write letters to the editors and orate from the soapbox on every possible occasion, often deny that there are any particular risks in industry. They delight to picture our larger industrial companies as fat jovial men labeled "Sugar Trust," "Oil Trust," "Beef Trust," etc., who have not a care in the world except their riotous pastime of squeezing and robbing a small, frightened, bristly-haired, unprotected figure labeled "The People."

But the business man who has a responsible part in some enterprise with the avowed and shameless purpose of "making money"—and it matters little whether the enterprise is a village

<sup>20</sup> See Appendix Vc.

grocery store or a metropolitan bank—will tell you a very different story concerning the risks of business. He is under no fond delusion that business enterprises “run themselves.” He will tell you of the shifting prices and supplies of raw materials, and the danger of carrying either too large or too small inventories. He will discuss labor shortages and unemployment, wage-scale agreements, efficiency, strikes, boycotts, walkouts, lockouts, picketing, arbitrations, injunctions, and accident compensation. After briefly touching upon insurance, advertising, and the problem of obtaining loyal and efficient management, he will have something to say also concerning sales managers and salesmen, expense accounts, sales policies, the protection of trade-marks, and the ever-changing markets for his products, with a few concluding remarks upon competition here and abroad, tariffs, bank accommodation, foreign exchange rates, and (possibly with a rising inflection) taxation.

Anyone who has followed him, except the purblind doctrinaire, will gather from his remarks some idea of why corporation net earnings and dividend rates vary so greatly, not merely from year to year, but even from month to month, and will begin to appreciate the truth of the statement by the late President Hadley of Yale University, that “The success or failure of a man engaged in manufacturing, transportation, or in agriculture depends more upon his skill as a prophet than upon his industry as a producer.”

**Assumption of Risk in the Modern World.**—These risks of business pervade the entire field of human enterprise. They are fundamental to and must be borne by the manufacturer, the wholesaler, the jobber, and the retailer in every line of trade. In a large measure the contractor, the builder, the banker, the real estate dealer or owner, or anyone who creates or constructs anything in the present to sell in the future—all are speculators. The farmer, who continually stakes his capital and his judgment against even the blind forces of nature, is probably the most persistent, heroic, and useful speculator in the country.

Professional men also are frequent if not universal speculators. The lawyer and the doctor who spend money (sometimes borrowed) to obtain their technical training, with the hope of later recovering it from future earnings, are speculators of the purest dye. Even the grim old New England adage, "There's nothing sure but death and taxes," is belied by the insurance companies and the tax experts, two highly speculative pursuits.

Everywhere in the world that inevitable business risks have arisen, some speculator has been forced to assume them, either of necessity, or voluntarily in the hope of a large possible profit. These risks can no more be abolished by legislative fiat than the tides can be halted. They are inherent in the nature of things. And thus modern corporations pass on their risks to their share certificates and to the individuals who own them. With the augmentation of the volume of business and the processes of specialization rising to sustain it, a special class of speculators has been created who make it their business to assume the risks of enterprise for a possible profit, by buying and selling corporate shares. For the same reason, organized markets have sprung up for securities, where this necessary and inevitable traffic in the risks of business by speculators can be conducted in the fairest, most efficient, and least hazardous manner.

**Antiquity of Speculation.**—Speculation is an immemorial handmaiden and companion of trade. Every schoolboy has read how, in the dawn of history, Joseph anticipated the "cycle theory" of prices by his dream of seven fat and seven lean years, and by accumulating and "cornering" wheat, prospered exceedingly in the land of Mizraim, in the shadow of the recently erected Pyramids. The more curious student of history may likewise have run upon the story of the ancient Greek philosopher, Thales,<sup>21</sup> who, upon being jeered at by the king

<sup>21</sup> "Thales, being a man of moderate means, worked his corner by securing options on the use of the presses at the next harvest season." (H. C. Emery, *Speculation on the Stock and Produce Exchanges of the United States*, p. 33).

The original citation of Thales' corner can be found in Aristotle's *Politics* (Jowett's translation) I, II, 58.

for having fallen down a well while gazing at and theorizing upon the stars, proceeded to give a startling proof of his practical ability by cornering the supply of olive presses and making the king and his subjects pay through the nose for them. Even the much regretted short sale is at least as old as Esau, who sold his inheritance (which of course he didn't own) to his brother for a mess of pottage.<sup>22</sup>

**Speculation and the Growth of America.**—Of all the peoples of history the American people can least afford to condemn speculation in those broad sweeping strokes so beloved of the professional reformer. The discovery of America was made possible by a loan based on the collateral of Queen Isabella's crown jewels, and at interest, beside which even call loan interest rates look coy and bashful. Financing an unknown foreigner to sail the unknown deep in three cockleshell boats in the hope of discovering a mythical Zipangu cannot by the wildest exercise of language be called a "conservative investment." Later, the two dominant colonies on our Atlantic seaboard, Massachusetts and Virginia, were established as the direct result of stock speculation in London in the shares of the Plymouth and London companies.<sup>23</sup> Neither was the 6% loan of the newly established United States of America, by which this country was originally financed, in the modern sense of the word "a conservative investment," as the old brokers under the buttonwood tree could testify. Moreover, our government has time after time speculated in real estate to an advantage to the public which is simply incalculable.

When enterprise assumed corporate form in the last century, our vast present-day railroad system was built primarily by speculators. Railroad pioneers, like the late James J. Hill, boldly projected their lines through the pathless forests, across rivers and lakes, through mountains and over mountain ranges with unbuilt cities and non-existent traffic in their vision. In

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<sup>22</sup> See Genesis, XXV, 29,

<sup>23</sup> See Chapter I, p. 10.

the industrial field, similar leaders successfully capitalized the future conditions of demand by creating vast industrial units. From its foundation to the present day, America has been preeminently the nation of the pioneer and the trail-blazer. Its present wealth has been mainly due to bold and yet wisely conceived and skilfully executed speculation, rather than such universal thrift and saving as characterizes France and other continental nations. It is after this unparalleled historic record of national energy, foresight, and speculation in almost every manner of business that the American public, with that mental capriciousness which is at once the admiration and despair of those who seek to serve it, solemnly shudders and condemns "speculation" as an innate and quite unnecessary piece of wickedness! For once we would do better to consider the words of the German economist Cohn, who said that speculation is in reality "the struggle of intelligence, armed with a knowledge of the ascertainable conditions, against the blind workings of fate."

**A Socialist's Testimony Regarding Speculation.**—Unexpectedly enough, the necessity of speculation is confirmed even by the ablest socialistic thinkers, such as P. J. Proudhon, the "Father of Anarchism," who declared:<sup>24</sup>

Speculation is nothing else than the intellectual conception of the different ways in which labor, credit, transportation and exchange can unite in production. It is speculation which discovers riches, which invests the most economical means of securing them, and which multiplies them by new forms or combinations of credit, transportation, circulation, and exchange by creating new wants or by the incessant redistribution of fortunes.

Consistent socialists object to private property, either absolutely or relatively, but they realize quite clearly that so long as we have private property, speculation in it will occur. This is not the place to ask our socialist friends exactly how in their nebulous superstate of the future the risks of industry will be

<sup>24</sup> See *Manuel du Speculateur à la Bourse* (Paris, 1854).



borne, if not by the private speculator, nor to inquire what is the moral of Lenin's recent experiment in Russia in "abolishing" both speculation and private property. Yet it surely argues little for the wisdom or consistency of those who condemn socialism as roundly as the writer could wish, that they should be equally ready to attack speculation, which is one of the cornerstones of private property and private ownership.

But we must not hold the idea that speculation, with all the harm it occasionally works to the individual, is simply an ancient and unshakable evil which fate has condemned us to endure with what grace we can muster. Speculation in several distinct ways is a positive and constructively beneficial factor in modern civilization, as a moment's reflection will show.

**Speculation a Phase of All Pioneering.**—Financial speculation plays an integral part in all pioneering and in all the preliminary and experimental stages of new enterprise. In almost every instance, financial speculation has been the mainspring and economic basis of those bold and hazardous explorations which have discovered and opened up new continents, and of those inventions which have subjected even the blind forces of nature to man's will. Behind almost every pioneer whom history has declared a hero has stood some financial speculator, unhonored, unsung, and usually forgotten, who nevertheless must have possessed some of the hardihood and imagination of the actual adventurers whom he financed. Even good Queen Bess, so the story goes, did her share in financing the bold Francis Drake in his amazing forays upon the plateships of the Spanish Main, which cleared the way for the British colonization of North America. And so it has been since her day with adventurers and pioneers, successful and unsuccessful.

No business in the world is so entirely judged by results as speculation; if the adventure succeeds, the speculator is proclaimed a genius, while if it fails, he is ridiculed as a credulous fool. And yet, however valuable or practical the inventor's

model or the scientist's discovery may seem, the financial speculator must actively intervene before they can be placed at the daily service of mankind. As Hirst so well says:<sup>25</sup>

The rapid development of material resources, mining, agriculture, manufactures, transportation, is of necessity associated with speculation. For speculation in the best sense is the investment of capital and the use of credit to finance enterprises which promise to yield handsome profits. But for a verdant and evergreen faith, salted with the love of risk and adventure for their own sakes, how could mountains be bored and waters bridged? If there were not superstition, there could be no religion; if there were no bad speculations there could be no good investments; if there were no wild ventures there would be no brilliantly successful enterprises; the same sort of sentiment which gave Dr. Cook a temporary notoriety invested Hansen with permanent fame. New York, then, must be valued fairly, not as a sort of gambling hell, but as a nerve center of North American enterprise.

#### **The Economic Value of Unsuccessful Speculation.—**

Almost all intelligently conducted experiments serve a useful purpose in the long run. The real invention, like the telegraph or the combustion engine, which is at first usually deemed only a "cracked inventor's dream," provides a direct illustration of the value to society at large of financial speculation. But even failures may not be without an ultimate economic benefit. Just as in science there have been no striking discoveries without many futile experiments, so too in finance there have rarely if ever been great successes which have conferred services upon millions, without preliminary unsuccessful speculations. It was not until railroading on wooden rails, with sails, mules, and hand-cars as motive power, had been eliminated from the field of practical possibility by actual and costly trial that steam railroading on steel rails finally became a success. If the successful speculator is the hero of progress, the unsuccessful speculator is often the martyr to progress. If the Anglo-Saxon race had always waited for a "sure thing," it would still be tending goats on the foothills of the Himalayas, instead of directing the destinies of most of the civilized world today.

<sup>25</sup> Hirst, "The Stock Exchange," p. 244.

Moreover, in the course of unsuccessful experimentation financed by the speculator many invaluable by-products have been accidentally discovered. The mediæval alchemists failed to discover the philosopher's stone which would turn base metals into gold, but they laid the foundation of modern chemistry. The original American oil men sought only the raw material for a patent medicine, but they laid bare the Pennsylvania petroleum fields. Raleigh mistook iron pyrites for gold, but he started the colonization of North America. It is probably no exaggeration to say that most of the scientific discoveries upon which modern civilization is so largely based, have resulted from the accidental discoveries of a disappointed and unsuccessful speculator.

Thus, in the onward march of civilization the speculator is the advance scout and pioneer of economic civilization. It is he who reconnoiters the posts of danger, who first attracts the enemy's fire and bears the first brunt of his resistance. From Friar Bacon to Edison, inventors and the speculators who financed them have been the eyes of business, without whom industry and trade would lose their sense of direction. Very often the speculator is quite unconscious of the larger economic significance of his work. He simply wants a profit. Yet just this willingness to take risks for possible profits has made the United States the dynamic and progressive country that it is today. It has been by such blind groping and stumbling toward the light that modern civilization has been achieved.

**Exploration Replaced by Exploitation.**—The age of Balboa and Magellan is past. In the field of pioneering the risks of exploitation have replaced the risks of exploration. Speculation today is concerned, not with "lands beyond the sunset" or "perilous seas forlorn," but with new oil concessions, new railroads, and new industrial projects organized as corporations, with shares to sell. In consequence, Wall Street has become the last frontier and the true haunt of the modern

pioneer. It is here, through the great banking institutions, the investment houses, and the Stock Exchange, that the pioneering capital of the nation sustains the present-day adventures of discoverers and inventors. This adventurous spirit of the modern capitalist, expressed in the acquisition of speculative shares, is a most essential forerunner to progress. It is closely akin, as Mr. Van Antwerp has pointed out,<sup>26</sup> to that spirit of "divine unrest" which every active and enterprising man possesses. Remove speculation from society and you would emasculate the creative instinct and the forward-looking energies of the human race.

**Modern Civilization Built upon Risks.**—It is not until speculation is crippled or temporarily withdrawn that we see it in its true perspective as a necessary, energizing, and creative economic force. If suddenly speculation could be abolished, not merely new inventions and further progress would be halted. Even established enterprises and existing organizations could no longer be carried on without it. It is not until times of economic stress and uncertainty come on, that men realize upon what frail and tenuous foundations our boasted modern civilization rests. Governments, as well as private corporations, have their financial risks, which are borne largely by investors and speculators who purchase their bond issues through the stock exchanges. The modern world has permitted the manufacture of credit instruments whereby its governments capitalize their future taxing power, and its business corporations capitalize their future earning power. It has built up a vast city life upon the sensitive and delicate mechanism of paper and metallic currency. It has become so accustomed to presuppose the speculator in all these things and countless others as well that it no longer appreciates the risk and burden of the world's business which he bears. And when the ignorant and violent political theorist lays violent hands upon the specu-

<sup>26</sup> See Van Antwerp, p. 35.

lative mechanism of modern life, as has so recently happened in Russia, the economist can afford to predict with Prospero:<sup>27</sup>

The cloud-capped towers, the gorgeous palaces,  
The solemn temples, the great globe itself,  
Yea, all which it inherit, shall dissolve  
And, like this unsubstantial pageant faded,  
Leave not a rack behind.

**Speculation in Times of Calamity.**—In times of adversity, when business is faced with an apparently cheerless future, at what might be called the “zero hours of industry,” the speculator, who is so often falsely considered the villain of our whole economic drama, clearly and unmistakably becomes its hero. A striking example of what speculation can do in a national crisis occurred in France in 1871, after her overwhelming defeat by the Prussians. In that dark hour of France’s destiny a revolutionary commune composed of the dregs of Paris ruled her capital; her armies were crushed and all but her unconquerable soul prostrate; two of her most valuable industrial provinces were lost; the Prussian armies stood victorious on her soil, and she faced the huge indemnity of five billion gold francs. If ever the outlook for French business—yes, and for the solvency of the government itself—seemed hopeless, it was then. And yet, as is well known, France’s recovery from her prostration was so swift that it astonished the world. How was this remarkable recovery brought about? Let one of the foremost historians, economists, and publicists of France, M. Anatole Leroy-Beaulieu, answer this question for us:<sup>28</sup>

Let us recall the already remote years of our convalescence, after the invasion, years at once sorrowful and comforting, when with the gloom of defeat and the suffering of dismemberment, mingled the joy of feeling the revival of France. Whence came our first consolation, our first vindication before the world? Whether glorious or not, it originated on the Bourse. . . . When more than one political skeptic and discouraged thinker allowed themselves to write down upon the

<sup>27</sup> See *The Tempest*, IV, 11, 152-156.

<sup>28</sup> See “La Regence de l’argent,” in *Revue des Deux Mondes*, February 25, 1897, pp. 894-895.



crumbling walls of our burned-down palaces "Finis Galliae," the Bourse kept its faith in France and her fortune, and that faith in France was spread by it all around, at home and abroad.

Speculation was patriotic in its way; it exhibited a confidence in our resources which the discretion of many a wise man rated as foolhardy. Have we already forgotten our great loans for liberation? Without the Bourse, these colossal loans, the amounts of which exceeded the dreams of financiers, would never have been subscribed for, or, if ever, it would have been only at rates much more onerous for the country. . . .

If France regained her rank among the nations of the world so quickly, the credit for it should be given mainly to the Bourse. And to its services in war, we should, if we wanted to be just, also add its services in time of peace. Without the extensiveness of the Paris market, and the stimulus given to our capitalists through speculation, how many things would have remained unaccomplished in the recklessly overdriven condition of our finances? We should have been unable to complete our railroad system, or renew our national stock of tools, or create beyond the seas a colonial empire which shall cause France to be again one of the great world powers. When the Bourse is on trial, such credentials should not be overlooked. Before condemning it in the name of morality and private interests, a patriot should give due consideration to its services rendered for the national weal; if all its defects and misdeeds be heaped up on one scale tray, then services of like importance will easily counterbalance them.

This is the testimony, bear in mind, of a member of the Academy of Moral and Political Sciences, and a citizen of France, that thriftiest and most cautious race of investors in the world.

**A More Recent Example.**—Nor do we need go so far afield as France, nor so far back as a half-century, to cite equally significant instances of the intervention of the speculator to maintain civilization during a time of stress and doubt.

The vast readjustment from war to peace conditions, after the fleeting and feverish boom of 1919-20, threw the whole world into the depths of an economic depression unparalleled in modern times. Age-old thrones had crashed. Novel experiments in government were being attempted. Long-established

national boundaries were shattered by the stroke of a pen. Almost the whole complex system of international trade and finance was seriously dislocated. While over-production and unsalable surplus overflowed the warehouses of some countries, in others arose the greatest goods famine of modern times. Over all extensive unemployment cast its dark and lengthening shadow. Many serious thinkers declared that civilization had committed suicide, that international finance would never recover, that the gold standard had been destroyed, and that industry and trade had received their death-blow. Only a ruinous period of economic prostration loomed ahead.

It was under these conditions that the venturesome buyers of speculative securities dared to sustain both public and private credit by purchasing stocks and bonds. The New York market led the way, but presently other centers both here and abroad also rallied to the task. Confidence, exhibiting itself on the Stock Exchange feebly at first but soon stronger and stronger, followed the ticker tape's ascending prices upwards. Loans were floated for embarrassed foreign governments and tottering industries. That virile spark of faith in the future first struck on the Stock Exchange spread from industry to industry, and from nation to nation. And soon the factory chimneys of the world smoked again, its harbors swarmed anew with the bustle and clamor of commerce, and its mills shook with the roar of renewed production.

**Function of the Stock Speculator.**—The stock speculator, then, is needed at all times by American industry to absorb and largely segregate its risks, and thus make conservative investing possible for less daring men. New enterprises, and weak uncertain enterprises particularly, call for his constant courage and audacity. In more normal times we may perhaps complain of his occasional fits of overenthusiasm or overdespondency, albeit he has in general an uncanny way of correctly forecasting values. But we have and will invariably rely upon his courage

and daring when the industrial clouds gather and business men fear for the darkening future.

So long, therefore, as the pioneer spirit is strong in our people, so long as new business enterprises are attempted or old enterprises entail risk, we will have the speculator with us. And, if we are to maintain our amazing rate of industrial progress, we will need the speculator to bring forth the inventor's dream and the scientist's discovery out of the workshop and the laboratory and place them at the practical service of mankind.

### **Speculation Necessary to Improved Marketing Methods.**

—Finally, there is another economic service performed for society as a whole in which speculation plays a prominent and essential part—that of assisting in the creation and maintenance of the exchanges. The several signal economic benefits rendered by these organized markets have been noted with some detail in an earlier chapter.<sup>29</sup> All but a few of these services rendered by organized markets depend directly and fundamentally upon speculation. Listed securities, both stocks and bonds, are in a practical way rendered negotiable by the Exchange, because speculators there will usually sell on a slight advance and purchase on a slight recession. Without this continuous stream of speculative bids and offers coming into the stock market, the investor would not regularly and quickly be able to buy or sell, because he would not be able to find a seller or buyer with whom to strike his bargain. The superior collateral value of listed securities is also basically due to speculation, because it is based upon their instant negotiability. It is likewise true that the capital made available for industry through the Stock Exchange, as well as the direction given to this capital into one rather than another industry, comes in the first instance from speculators.<sup>30</sup>

<sup>29</sup> See Chapter II.

<sup>30</sup> See Chapter IV, p. 116.

Reciprocally, the Exchange is of vast significance to thrift and investment, not only in rendering the investor's securities always negotiable, but also because a speculative "floating supply" is maintained through its efforts, in which securities can rest until they are sufficiently seasoned to warrant their purchase by investors.<sup>31</sup> Furthermore, the distinctive ability of an organized market to frustrate attempts at manipulation or monopoly is due to the free play of national speculative forces in it. The fact that an exchange can establish the fairest prices is likewise due to the fact that any disparity between price and value makes speculative profits possible. It is therefore apparent that a stock exchange in which speculation was either forbidden or else restricted in any artificial and unnatural way by taxation or legislation, could not perform those vital economic functions without which corporate enterprise of any magnitude in this country would soon be dangerously impaired.

**Relation of Speculation to Organized Markets.**—That they serve as speculative markets for securities is perhaps the principal virtue and chief economic justification of the stock exchanges. It should be noted, however, that the latter are comparatively recent additions to the mechanism of credit and business, while speculation is an ancient force in the world's business and inseparably bound up with the processes of trade. Speculation existed centuries before the organized markets in which much of it is today conducted.<sup>32</sup> It is therefore obvious that speculation created the exchanges, not the exchanges speculation. The Stock Exchange, as in the case of other organized and speculative markets, resulted from a natural economic evolution, and serves to segregate speculation, to minimize its dangers, and to intensify its practical and abstract benefits. It is as illogical to blame the sometimes costly shifts of speculative forces upon the Exchange as it would be to accuse the life insurance company of murdering a policyholder.

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<sup>31</sup> See Chapter IV, p. 107.

<sup>32</sup> See Chapter II, p. 37.

**Adjusting Prices to Values.**—We have seen that the occasion for a successful speculation comes only when a disparity exists between the price and the value of some commodity or enterprise. The principle is exactly the same, although, of course, on a smaller scale, with a speculation in the stock market, or with the founding of a new industry, wherein a large potential value seems creatable for a small price. It is this fundamental fact with regard to speculation which led Justice Holmes of the United States Supreme Court to remark, "Speculation is the self-adjustment of society to the probable." The speculator, therefore, as M. Bloch, the French economist, has declared, renders an economic service every time his speculation succeeds. For this service, when he succeeds in rendering it, the speculator of course obtains a profit, and this profit, considering the profound economic benefits of speculation, is as well deserved as any other.

One logical deduction from the premises stated above is that unsuccessful speculation is economically harmful, and this is in many practical ways true. But such speculation is always kept from becoming an excessive economic harm for the simple reason that the speculators suffer losses and are penalized for running counter to the trend of true values.

**American Fondness for New Legislation.**—It is impossible to legislate speculation either out of existence or into absolute harmlessness to the individual speculator.<sup>33</sup> Probably more than any people on earth, Americans have contracted the habit of rushing headlong into statute-making. That so many ill-considered and superficial attempts to inaugurate the millennium with a new law are actually enacted, is emphatically more our own fault than that of our elected representatives, whom, nevertheless, we invariably blame for the whole affair later when the law is found impossible or else dangerous in its enforcement. However we may rail at Washington or the state capitals, most of the uneconomic and useless statutes

<sup>33</sup> See Appendix Vd.



which are enacted each year are primarily due to our own unwillingness to perform the duties of intelligent citizens. If we get bad laws, we have ourselves to blame for it.

One of the seemingly perennial sources of economic legislation that is unenforceable and harmful is speculation and the various forms it takes in the business world of today. Justice Holmes of the United States Supreme Court has tersely and shrewdly stated the situation regarding such legislation:<sup>34</sup>

It's true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by attempting to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being, are harmful and vain.

The same general point—the impossibility of adequately and successfully halting speculation by statute—was testified to by the late H. C. Emery, probably the highest economic authority on speculation in America:<sup>35</sup>

You cannot stop speculation in industrial securities, and you cannot stop speculation in anything by any process of law. Just as long as the value of property fluctuates, men will buy and sell with a hope of profit. There will be speculation of some kind. If you throw it out of an organized exchange, you throw it out into the street. If you throw it out of Berlin you can throw it into London. But somehow and some way, just as long as wheat fluctuates in value, people are going to buy and sell wheat; just as long as land fluctuates in value people are going to buy and sell land. Just as long as stocks fluctuate in value, people are going to buy and sell stocks.

**Legislation and Economic Principles.**—That this view of the matter is correct is borne out by the experience of all nations at all times. Particularly in the typical instance of the much abused short sale, the most meticulously drafted regulative laws passed in England, Germany, France, and this coun-

<sup>34</sup> Chicago Board of Trade Case, May 8, 1905.

<sup>35</sup> "Regulation of the Stock Exchange," p. 325.

try tell only of failure and final repeal.<sup>36</sup> The fact of the matter is that in attempts to legislate concerning so universal and fundamental a matter as speculation, the statute-makers set themselves against more powerful laws than any statute which ever adorned the printed page—the irresistible economic laws by whose processes nations have risen and fallen, and owing to whose unimpeded operation not merely progress, not merely the maintenance of the present business and social order, but the ability of the human being to find the food, shelter, and clothing necessary to mere existence and life itself, are basically and necessarily due. These principles defy the passing fiat of unwise legislators and hasty public opinion almost as completely as the law of gravitation. The law-makers who attempt to hamper with unscientific legislation the life-giving economic energies released by speculation, are embarking on perilous waters; any temporary success of their efforts only intensifies the ultimate recoil of pent-up economic forces to the destruction of civilization and human life.

**Education the Only Genuine Remedy.**—This is as true of speculation in the stock exchanges, although the bearing here is less direct and obvious, as it is of speculation in the wider fields of agriculture and commerce. The complex and tested machinery by which the New York Stock Exchange practically and successfully administers the principal American market place for securities, with constant regard for the fundamental economic forces exerting themselves within it, affords a steady contrast in the swiftness and flexibility of its operation to the dogmatic and futile statutes concerning speculation with which the history of legislation from the Middle Ages to the present day is replete. Evils in the speculative factors inherent in production and distribution there undoubtedly are, but there exist no possible legislative short-cuts or panaceas for their abolition. Only the slow and tedious but old and sure method of educating the people into an understanding of economic law, particularly

<sup>36</sup> See Chapter VII, p. 200.

as it exerts itself in the organized and unorganized markets, can be of practical value in reducing the harm which so universal, inevitable, and powerful an economic force as speculation occasionally works upon the individual.

In conclusion, one can at least take consolation in the fact already stressed, that so far as prices are concerned speculation swiftly readjusts and eliminates the results of its occasional excesses. Leroy-Beaulieu not inaptly sums up the matter by stating that "the evils which speculation prevents are much greater than those it causes." But the best summary of a difficult question has probably been made by the brilliant British logician, philosopher, and economist, John Stuart Mill :

The operations of speculative dealers are useful to the public whenever profitable to themselves. The interests of the speculators as a body coincide with the interests of the public, and as they can only fail to serve the public interest in proportion as they miss their own, the best way to promote the one is to leave them to pursue the other in perfect freedom. Neither law or opinion shall prevent an operation, beneficial to the public, from being attended with as much private advantage as is compatible with full and free competition.

## CHAPTER VI

### A TYPICAL INVESTMENT TRANSACTION

**Bidding and Asking.**—Before plunging directly into a detailed account of how securities are purchased and sold on the Stock Exchange, it is necessary to consider in a general way what sales are and how they are made. Every sale on the Stock Exchange, or anywhere else for that matter, naturally involves two separate parties—a buyer and a seller. The buyer, who expresses the demand for the property to be purchased, wishes, of course, to obtain it as cheaply as possible, while the seller, who expresses the supply side of the market, is equally desirous of getting the highest possible price for his goods. The interests of the buyer and the seller are, therefore, in direct opposition to each other. Hence, the seller almost invariably “asks” more for his goods than the buyer willingly “bids,” and usually it is only after considerable higgling that a compromise is reached and a sale is effected at some intermediate point in the “spread” or difference between these bid and asked prices. When, for example, A tries to sell his automobile for \$500 to B, who only wants to pay \$400 for it, the situation might be described in financial language as “\$500 asked—\$400 bid.” If A was only as anxious to sell as B was to buy, they would probably split the difference or spread of \$100 and close the deal at \$450. But if A was more eager to sell than B to purchase, he might have to take \$425 or less for his car; while if B was more eager to purchase than A to sell, he might have to pay \$475 or more.

**Market Price Fluctuations.**—Obviously, the stability of any price must depend upon the extent of the “spread” between existing bids and offers. When the “spread” amounts to 100

points, as in the case of the automobile cited above, the next sale price might occur at any point within that range.

In proportion as a market is organized, and all bids and offers brought speedily into it, a severe competition between bidders and between offerers ensues, with the result that the spread is made between the highest bid and the lowest offer. For this reason, not only are price fluctuations between sales minimized, but fairer prices and enhanced negotiability are also attained. This is clearly the case with as highly organized a market as the New York Stock Exchange, upon whose floor the buying and selling orders of the entire nation converge.

The Rules of the Exchange (Chapter I, Sec. 9) provide that ordinarily "bids or offers shall not be made at a less variation than  $\frac{1}{8}$  of one dollar in stocks, and  $\frac{1}{8}$  of 1% of the par value of bonds." This naturally means that market prices are usually quoted by  $\frac{1}{8}$ s or multiples of  $\frac{1}{8}$ s.

**Work of the Commission Broker.**—With this general philosophy of prices the average broker is, of course, perfectly acquainted, although his mind is too fully occupied between the trading hours of 10 A.M. and 3 P.M. with specific orders to spend over-much time pondering upon it. His business consists not of theorizing about the forces of supply and demand, but of executing the buying and selling orders caused by those forces, amid the posts, tickers, telephones, and signal boards on the Exchange floor. If we are to comprehend his everyday work, as well as the Stock Exchange machinery whereby he is enabled to carry it on, we must follow a typical "investment transaction"<sup>1</sup>—that is, an outright purchase and outright sale of a given security—through all its various stages from beginning to end.

**Origin of a Selling Order.**—To commence with the supply or selling side of the transaction, we find Mr. Jones of Baltimore one fine morning reading the stock ticker with evident

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<sup>1</sup> See Chapter V, p. 125.



interest. Some months before, Jones had bought 100 shares of U. S. Steel common stock as an investment. Since that time the dry goods business which he conducts in Baltimore has grown so rapidly that funds for its expansion are now urgently needed. Jones had noticed that his Steel common was selling at about 150—that is, at \$150 a share—and has decided to sell his shares and put the money into his business. Accordingly, he went to his bank, obtained his stock certificate from his safe deposit box, and took it over to the office of Jenkins & Co., his brokers, where he now stands over the ticker. After again satisfying himself by glancing at the tape that U. S. Steel is selling at 150 or better, Jones decides to sell at once and prepares a selling ticket.

There are several different ways in which he can make his order out, depending, of course, upon his exact wishes regarding the sale of his stock. If Jones indicates a definite price at which he will sell his stock, the order is called a “limited” order, and can be executed only at or above the price designated.<sup>2</sup> But if no price limit is set, it is called a “market” order, and is executed at the most advantageous price obtainable in the market at that particular time.

**Usefulness of the Stop-Loss Order.**—Jones might wish to place a stop-loss order, so as to limit any losses which he might encounter in the stock he purchases. He might, for example, at the time he gave an order to purchase 100 American Sugar at 85, also order his broker to sell that amount “on stop” at 80, in order to limit his loss to around 5 points on the stock so purchased. A stop-loss order is a limited order until the limit is reached, when it becomes a market order. For example, until Sugar sells down to 80 it is not executed, but once this stock has descended to this price, the order becomes an active market order calling for immediate execution.

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<sup>2</sup> A limited order to buy would of course be executed only at or *below* the price indicated.

The exact figure at which a stop-loss order is executed, therefore, depends entirely upon the exact conditions in the market at that time. If Sugar falls to 80 but rebounds to 82 on the next sale, the customer may sell out his stock on his stop-loss order at about that price. But if Sugar, after reaching 80, should sink further to 78, it is around the latter price that the stop-loss order will probably be executed.

Simply because the limit on a stop-loss order is set at 80, therefore, is no reason that the customer should expect to make his sale at just that price.

Of course, stop-loss orders placed above the market to protect the short seller from a swift rise in prices are just as permissible and customary as similar orders placed below the market to protect the purchaser from a drop in prices. Since so many stop-loss orders are in practice handled by the specialists, some further points concerning their execution will be treated in the chapter which outlines the specialist's work.<sup>8</sup>

**Forms of Limited Orders.**—Orders also differ as to the time for which they remain good. If Jones marks "G.T.W." on his order, it means that it is "good this week" and that after the next Saturday it will become automatically void. Similarly, an order marked "G.T.M." is "good this month." But an order marked "G.T.C." is by that fact "good till countermanded," and remains in force indefinitely. Of course, only limited orders ever bear these symbols—market orders are for immediate execution without any limit as to price, and do not involve the element of time.

**Transmission of the Order.**—To return to Jones as he is making out his selling order, he decides, after a moment's reflection, to "put a limit" of 150 on his stock, and accordingly places this limit as well as the letters "G.T.C." on the slip.

He then gives the slip to the customer's man in Jenkins & Co.'s office, who at once turns it over to the order clerk. It is

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<sup>8</sup> See Chapter VIII, p. 229.

the business of this order clerk to record and supervise the transmission of orders to the main office of Jenkins & Co. in New York, over the company's private telegraph wire.<sup>4</sup> In the present instance, he sends Mr.

Jones's order to the wire room, where the wire operator telegraphs the order over the firm's private wire to its New York office. The moment Jones hands his order slip to the customer's man, he thus sets in motion the whole machinery of the Stock Exchange for executing orders and for the clearance and delivery of stock—a machinery concerning the complexity of which Mr. Jones has probably only a vague notion.

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|-------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>SELL</b></p> <p><i>100 Steel</i></p> <p><i>150</i></p> <p><i>G. J. C</i></p> <p><b>JENKINS &amp; CO.</b><br/><b>XX 12</b></p> |
|-------------------------------------------------------------------------------------------------------------------------------------|

Figure 8. Floor "Sell Slip"

**In the Wall Street Office.**—While Jones lingers in the Baltimore brokerage office to watch for the record of his sale on the tape, the scene shifts to New York. In the main office of Jenkins & Co. at 500 Wall Street, a wire operator sits waiting for just such out-of-town orders as Jones's to come in over the firm's private long-distance wires. He receives the message from Baltimore to "sell 100 Steel at 150," and turns it over to the order clerk, who makes a record of it for filing purposes and transmits the order at once to the Exchange floor over the private telephone maintained by Jenkins & Co. for this very purpose. The telephone of Jenkins & Co. is situated in one of the many telephone booths which fringe the Stock Exchange floor.<sup>5</sup> (Plate 6.) The firm's telephone clerk immediately takes down the order on a specially prepared selling slip (Figure 8), containing Jenkins & Co.'s name and a letter and number which indicate the location of their floor telephone.

<sup>4</sup> See Chapter XV, p. 436.

<sup>5</sup> See Appendix IIIh.

**Signaling the Exchange Broker.**—The next step is, of course, for the phone clerk to get this order into the hands of Mr. Jenkins, who as a "floor member" personally executes on the Exchange the orders received by his firm. If the order were for an odd lot—that is, for less than 100 shares—the phone clerk would probably send the written order to the "Steel post," where it would be handed over to an odd-lot dealer for execution.<sup>6</sup> If the order were for 100 shares, but limited at a price far away from current prices, it would perhaps be advisable to send it to the specialist in Steel,<sup>7</sup> since the latter is always stationed at the Steel post. Also in certain exceptional instances, Jenkins' phone clerk might give the order to a page with instructions to find Mr. Jenkins and give it to him.

But, as is usually the case, the telephone clerk does not know where on the crowded Exchange floor Mr. Jenkins is, and he therefore signals for him by "putting up his number" on the annunciator boards on the walls of the Exchange trading rooms. Each broker has his own number and as he moves from one post to another on the floor he constantly watches for it to appear. Consequently, when Jenkins' telephone clerk presses a button beside his telephone, Jenkins' number, 371, suddenly appears in white on the great black signal boards. This at once attracts Jenkins' attention; he hastens over to his telephone booth and takes the order from the telephone clerk. In case Jenkins had been forced to absent himself from the floor at this time, he would probably have instructed his clerk to "give out" such orders during his absence to a "two-dollar" broker, in order that there might be no delay in their execution.

**Composition of a "Crowd."**—Every stock listed for trading on the Exchange is assigned to some particular post on the floor. Naturally there are many stocks traded in at each post. Jenkins quickly finds his way to the "Steel post," where U. S. Steel common stock is bought and sold. The so-called "Steel

<sup>6</sup> See Chapter IX, p. 236.

<sup>7</sup> See Chapter VIII, p. 212.



(Copyright by the New York Stock Exchange)

Plate 6. Tube Station and Telephone Booths on the Floor



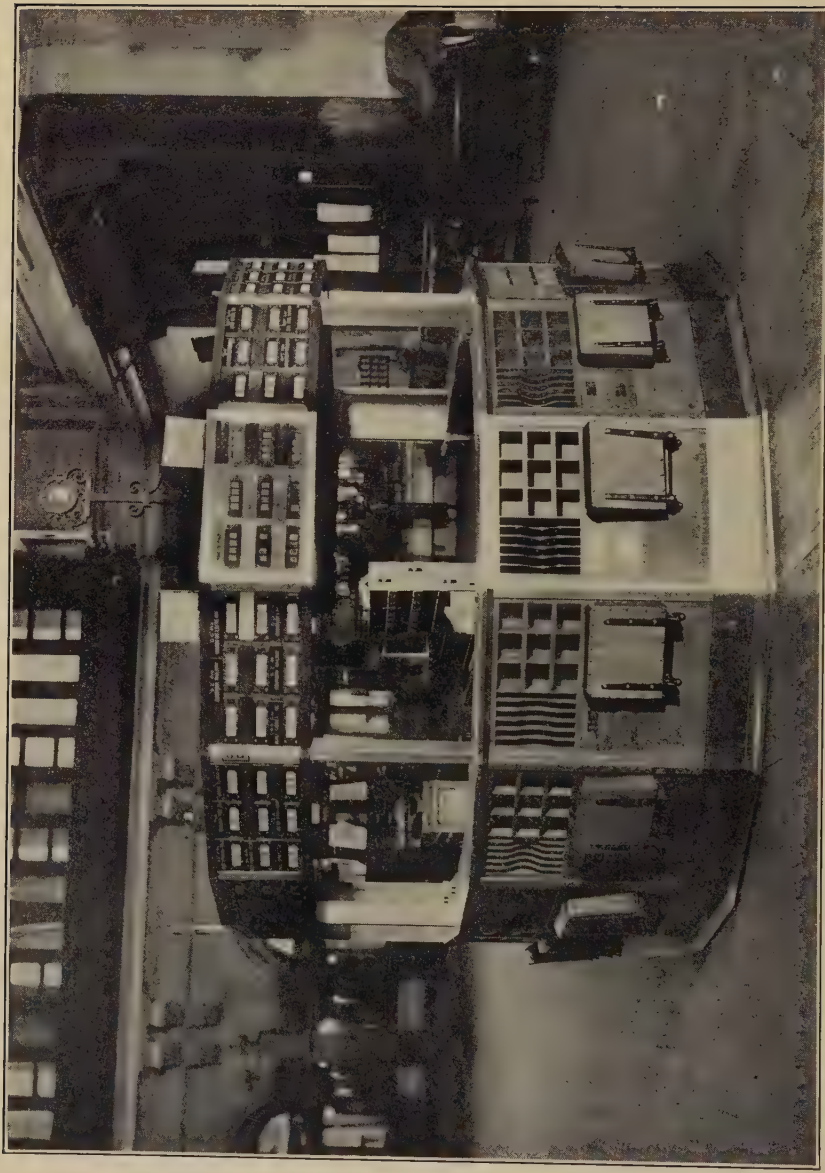


Plate 7. New Stock Post

(Copyright by the New York Stock Exchange)

crowd" about this post is composed not only of commission brokers like Jenkins, who are buying and selling the stock as agents for other Exchange members or outside principals, but also floor traders dealing entirely on their own account, odd-lot dealers who stand ready to buy or sell any number of shares less than the ordinary trading unit of 100 shares, and specialists who confine their dealings entirely to the particular stocks located at this post. This constantly shifting group of brokers and dealers represents almost the whole world demand and world supply of Steel stock at that particular moment.

Formerly, the "stock posts" on the Exchange floor were actual posts, provided with price recording dials on their sides and a circular seat about their base.<sup>8</sup> In order to conserve space on the trading floor, these former posts were in 1928-29 replaced by the present large, hollow U-shaped booths (Plate 7) to which the traditional term "post" has nevertheless clung. Inside each post is a tube station connected by pneumatic tubes with the members' telephone booths which fringe the floor;<sup>9</sup> these tubes are, as we shall presently see, employed primarily by the specialists<sup>10</sup> and the odd-lot dealers.<sup>11</sup>

The outside of the so-called post is pierced midway up by windows, above which hang metal plates stamped with the name of the given stock and price recording dials provided with movable figures which record the last sale-price. The price reporters keep these figures up to date, except when market activity becomes so great as to cause them temporarily to be neglected. At the end of the post also hang paper slips for the stocks at the given post; each day one slip is used to record the opening, highest, lowest, and last prices for that day, of all the stocks at the given post. These slips are posted each night after the close of the market, and are kept over the course of the previous few weeks. Owing to these price recording

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<sup>8</sup> See Appendix IIIe.

<sup>9</sup> See Appendix IIIg.

<sup>10</sup> See Chapter VIII, p. 214.

<sup>11</sup> See Chapter IX, p. 236.

dials and price slips, a broker or dealer on the floor can speedily acquaint himself not only with recent selling prices, but also with the latest price, for any particular listed stock issue.

Inside each stock post are stationed several clerks, who assist specialists,<sup>12</sup> record orders to buy or sell inactive stocks, man the tube system, and perform other useful functions. Attached to each post is also a quotation clerk who, upon request, obtains from the floor members at his post the latest bids and offers for a given issue, and reports them through a central station to Stock Exchange offices in the financial district.

**"What's Steel?"**—When Jenkins first arrives at the Steel post, he learns from the indicator and slip attached to the post that Steel common opened that day at 149¾ and that its last recorded sale was at 150⅛. But in order to obtain the absolutely latest information on the "market" for Steel, Jenkins thrusts his way into the Steel crowd, which is crying out bid and offer prices at which they will buy or sell the stock, and inquires, "What's Steel?" The specialist, who concentrates all his attention on this particular stock and consequently is thoroughly familiar with the subject, tells him, "150 bid, offered at ⅛," or perhaps replies simply "fifty to an eighth"—a shorter way of saying the same thing. In other words, the most any buyer at that particular moment is willing to pay for the stock is \$150 a share, while the least any seller will take for it is \$150.125 a share.

Jenkins' order is limited at 150—that is, he must sell his customer's stock for 150 or more. If this limit were far away from the market—say, at 200—the chances are that considerable time might elapse (perhaps indeed a number of years) before market conditions would make it possible for him to sell the stock at that price. In such a case Jenkins would probably leave the order with the specialist in Steel, who would inscribe the offer of 200 in his book.<sup>13</sup> Since the specialist

<sup>12</sup> See Chapter VIII, p. 218.

<sup>13</sup> See Chapter VIII, p. 220.

remains at a single post and confines his trading to a few of the stocks assigned to it, he would always be in a position to take advantage of any sudden change in market conditions by which Steel could be sold at a limit price of 200.

**Effecting a Sale.**—But in the present case the market is very close indeed to the limit of 150 on Jenkins' order. Jenkins is, of course, anxious to sell his customer's stock for the highest possible price. In an attempt to get for the latter an additional  $\frac{1}{8}$  over his price limit of 150, Jenkins accordingly joins in the chorus of voices and offers it at  $150\frac{1}{8}$ . But since no one seems willing to buy Steel stock at  $150\frac{1}{8}$ , the lowest price so far quoted by sellers, he next shouts, "Sell 100 Steel at 150." Scarcely has he uttered this offer than Wilkins, another commission broker in the Steel crowd, promptly shouts, "Take it," thus indicating that he will buy Jenkins' stock at the price the latter has named. If Wilkins had not been swift in buying the 100 Steel, some floor trader or specialist in the crowd might have forestalled him by purchasing it. Sometimes, indeed, two Exchange members will cry, "Take it" (or in case both are attempting to sell, "Sold!") at exactly the same instant. But they settle such a difficulty instantly and impartially by producing coins and "matching" one another to see which shall "get the sale." The winner thereupon enters the transaction on his records as a sale, while the loser remains at the post to buy the stock he is after from someone else.<sup>14</sup> The case of the sale of Steel at 150 here cited has purposely been kept as simple as possible, in order not to confuse the reader. There is, however, a very extensive and complex technique in effecting floor transactions; the rulings on more complicated market transactions than the example given here will be found in an appendix to this chapter.<sup>15</sup>

**Reporting the Sale.**—The magic words "Take it" mark the real point at which Jenkins' order is "executed," although

<sup>14</sup> See Appendix VIa.

<sup>15</sup> See Appendix VIb.



to obviate the possibility of any misunderstanding Jenkins takes the precaution to cry to Wilkins, "Sold to you 100 Steel at 150." Jenkins next writes out a ticket known as a "report"

**BOT**  
**SOLD** ✓

*100 Steel*

*150*

*Wilkins & Co.*

**JENKINS & CO.**

Figure 9. Floor Sale Report Slip

Recording the sale by Jenkins & Co. of 100 Steel at 150 to Wilkins & Co.

(Figure 9), recording the details of the sale which he has just made, including the name and amount of the stock, the price, and the name of the buyer, and sends it to his telephone clerk, who phones it back to his office. This main office of Jenkins & Co. on receipt of the report wires it in turn to the Baltimore branch, where Jones is informed of the transaction. It is, of course, to be noticed that Wilkins and Jenkins do not exchange securities, money, or even memoranda at the post, but simply make a verbal sales contract. The

actual delivery of the stock and payment for it, as will be explained in subsequent chapters, are effected through the complex and important agency of the Stock Clearing Corporation.

**Inviolability of Stock Exchange Contracts.**—The thorough insistence of the Stock Exchange upon the inviolability of contracts made on its floor is attested to by the readiness with which such contracts are effected.<sup>18</sup> We have seen in the typical transaction cited that Jenkins and Wilkins do not exchange any written agreement, but that a single word, or even a nod of the head, is sufficient to close a contract for the purchase and sale of stock valued at \$15,000. Indeed, millions of dollars' worth of securities change hands in the Exchange each day in just this way without signed agreements, and with less danger of loss through cancellation, per dollar involved, than

<sup>18</sup> See Chapter XVI, p. 454.



in any other kind of modern business.<sup>17</sup> There is no "welching on a trade" afterward; no evasion of a contract is sought or allowed. The wave of canceled contracts which occasionally sweeps commercial America never passes the threshold of the Exchange. No business institution or group in this or any other country can boast of higher commercial ideals, or of stricter adherence to what its constitution calls the "just and equitable principles of trade," than the New York Stock Exchange.

**Origin of Demand.**—An inquiry into the demand or buying side of this sale—that is, into what impelled Wilkins, the broker, to enter the Steel crowd and bid for stock, will lead us to San Francisco, three thousand miles from Wall Street. At almost the same moment that Jones was reflectively fingering his 100-share Steel certificate in the Baltimore brokerage office, a Mr. Smith was pondering over the ticker tape in a similar branch office of Wilkins & Co. in San Francisco. Smith has prospered in the Oriental exporting business and finds himself with a surplus of \$15,000, which he desires to invest. He at length selects U. S. Steel common stock as the security best fitted to his needs. Accordingly, he turns over his check for \$15,000 to the San Francisco branch of Wilkins & Co. and makes out a "buy" ticket for 100 shares of Steel, limiting the order to a price of 150 $\frac{1}{8}$  or less. In due course this order speeds through channels similar to those observed in the case of Mr. Jones's order to sell. The order clerk in San Francisco sends the order over a private telegraph wire to the New York office of Wilkins & Co.; thence it is relayed by private phone to the Stock Exchange floor, where a clerk takes it down on a buying slip (Figure 10); then Wilkins obtains and executes it. And, like the capable broker that he is, Wilkins obtained the stock  $\frac{1}{8}$  under the price limit set for its purchase by his far-away customer, by observing conditions and waiting at the post

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<sup>17</sup> See Appendix VIc.

for just the right moment to buy the stock. He reports the purchase to his telephone clerk on a slip shown in Figure 11.

**Machinery of the Ticker System.**—Meanwhile, the extensive and efficient machinery by which the daily transactions on the floor of the Stock Exchange are made public has not been idle. When Wilkins cries "Take it" to Jenkins' offer of stock at the Steel post, a quotation reporter at once notes the sale, the amount of stock sold, and the selling price. These re-

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|---------------------------------------------------------------------------------------------------------------------------------|
| <p><b>BUY</b></p> <p><i>100 Steel</i></p> <p><i>150 <sup>1</sup>/<sub>8</sub></i></p> <p><b>WILKINS &amp; CO.</b><br/>YY 15</p> |
|---------------------------------------------------------------------------------------------------------------------------------|

Figure 10. Floor "Buy Slip"

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|-----------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>BOT ✓</b><br/><b>SOLD</b></p> <p><i>100 Steel</i></p> <p><i>150</i></p> <p><i>Jenkins &amp; Co.</i></p> <p><b>WILKINS &amp; CO.</b></p> |
|-----------------------------------------------------------------------------------------------------------------------------------------------|

Figure 11. Floor Purchase Report Slip

Recording the purchase by Wilkins & Co. of 100 Steel at 150 from Jenkins & Co.

porters, who are employees of the New York Quotation Company (a corporate subsidiary of the New York Stock Exchange), are stationed all over the Exchange floor, and make quotation-reporting their exclusive business.

On the trading floor are several stations from which quotations are printed on the tape. The instrument used for this purpose has a key-board like a typewriter, and in a sense the operator seated before it is a typist. For no human agency, but only electricity, intervenes from the time he presses down a key and the time when the corresponding letter or figure is

printed on the tape in lower New York. Two separate ticker systems are maintained—one for bonds and one for stocks. With the former, there is only one sending instrument. But owing to the greater activity in shares, there are several such instruments for them. An ingenious electrical device coordinates the flow of their several electrical impulses into the printing of the single stock tape.

The ticker machines operated from the floor in this way are those of the New York Quotation Company, and their distribution is confined to Manhattan Island below Chambers Street. But from one of these tickers in the office of the Western Union Telegraph Co. in this district, an operator of the latter company reads the quotations as they appear, and transmits them to its tickers located all over the nation.<sup>18</sup>

**Reading the Stock Ticker.**—Ever since 1920, successive changes in the ticker quotation system have been effected in an endeavor to avoid delays in reporting the increasing volume of transactions.

Every listed stock issue is known on the tape by a certain letter or letters. U. S. Steel common, for example, is "X"; Pennsylvania Railroad stock is "PA," etc. These abbreviations give rise to much Wall Street "slang." Southern Pacific common (now "SX" but formerly "SP") used to be called "Soup" for short; Missouri, Kansas & Texas Railway common ("KT") is called "Katy," etc.

After the symbol for the stock is printed, there next appears the amount of it which has been sold. The sales-unit on the Exchange being 100 for shares, a sale of this amount is understood without being specially indicated, while a sale of 200 shares appears as "2."—of 300 shares "3.," etc. Finally the price itself appears. Until the heavy markets of 1928, prices were reported in full. But in that year, to further economize time, only the last digit (plus fractions) of the price was printed, it being presupposed that the reader of the tape would

<sup>18</sup> Appendix VIId.

know the price within \$10 per share. Thus, a sale of 300 American Tobacco at  $248\frac{3}{8}$  was formerly printed "AT  $3.248\frac{3}{8}$ ," but later "AT  $3.8\frac{3}{8}$ ," etc.

Thus it comes about that Jones, waiting in the Baltimore brokerage office, presently sees a quotation for U. S. Steel on the tape and has reason to think that it may be his stock which was sold, while at almost the same moment Smith in San Francisco sees the same quotation and has reason to believe that his buying order has been executed.

**Limitations of the Stock Ticker.**—Of course, the customer in an out-of-town brokerage office must not be too hasty in concluding that the first quotation which appears on the tape following the placing of his order of necessity represents the sale of his own stock. Both from the many physical steps outlined above which must be gone through to transmit and execute orders for stocks and to report their prices over the ticker, and from the mechanical limitations of the ticker system itself, it is obvious that considerable delays may sometimes arise between the placing of the order in the commission house and the appearance of the quotation on the tape. Furthermore, it is often good brokerage for the broker to wait, as Wilkins did, before executing a customer's orders. Smith was saved  $\frac{1}{8}\%$  on his stock through just such a delay. Yet if Smith, after placing his order, had begun at once to watch the ticker he might have thought that the very first subsequent quotation really represented the purchase of his own stock. If, while his order was en route to the floor, Steel should have sold at  $149\frac{3}{4}$  or  $149\frac{7}{8}$ , he would not in consequence be justified in leaping to the conclusion that he had suffered an injustice when he received his confirmation of his own transaction at 150.

**Inactive Stock Post.**—With unusually inactive stock issues, the above procedure followed with active stocks would not be equally satisfactory. In 1927, special methods for dealing in such inactive shares were inaugurated by the Exchange. A spe-

cial "inactive stock" post was provided, with facilities for filing bids and offers similar to the system maintained in the bond market. With inactive stocks, as designated by the Committee of Arrangements, the unit of trading is 10 shares, instead of the 100 share unit employed for active share issues.

**Complete Publicity of Stock Exchange Transactions.—**

But not only Jones and Smith are informed of their transactions in Steel; everyone in the country from Duluth to New Orleans, or from Portland, Maine, to Portland, Oregon, who is in any way interested in the market value of this stock, whether because he is a stockholder or only thinking of becoming a stockholder in the U. S. Steel Corporation, or because of the economic conditions in industry and trade which the price of its shares may reflect or even forecast, can gain almost instant information of the transaction in which Jones and Smith have figured, as well as every similar transaction that takes place that day and every other day on the Stock Exchange. The ticker service is of especial value to banks and other financial institutions.<sup>19</sup>

The uncanny swiftness and accuracy of the American stock ticker system invariably astonishes foreign visitors to America. Indeed, as eminent an economist as Paul Leroy-Beaulieu has strongly urged its adoption by the Paris Bourse.<sup>20</sup> It is safe to say that there is no other market in the world whose transactions are given as complete, as immediate, and as reliable publicity, as those of the New York Stock Exchange.

**Quotation System.—**In addition to the ticker system above mentioned, which reports transactions actually concluded upon the floor, the Exchange in 1928 also established another system for reporting current bids and offers for securities from the floor to its members' offices. In order not to render the example of the sale of 100 Steel too complicated, consideration of this system was omitted from the transaction.

<sup>19</sup> See Chapter XI, p. 293.

<sup>20</sup> See Appendix VIc.



Frequently, customers of brokerage houses will wish to ascertain such current bids and offers before buying or selling, particularly if Exchange dealings are heavy and the ticker is "behind the market." Formerly, this could be done by telephoning from a Stock Exchange office to the floor telephone and requesting the latest bid and offer. This method was never wholly satisfactory, however, and in the active markets of 1927 and 1928 became increasingly difficult.

The Stock Exchange accordingly devised a new system upon radically different lines. A quotation clerk was stationed at each stock post with a telephone to report the latest bids and offers as requested. A central switchboard service, located in the upper stories of the Stock Exchange Building, relays these current bids and offers speedily and accurately from the floor quotation clerk to any Stock Exchange house in the financial district which may have requested the quotation.<sup>21</sup> Although a very new development, this quotation system has already won its place among the services in Wall Street which increase the safety as well as the speed of Stock Exchange dealings.

**Value of a Ready Market.**—There is another aspect of the cited sale of 100 shares of Steel, which through the operations of the two Stock Exchange commission brokerage houses Jones of Baltimore has been able to make so quickly and satisfactorily to Smith of San Francisco, that deserves emphasis at this point. In all probability Jones never heard of Smith or Wilkins. He may not even know that such men exist, and, granted the Stock Exchange system, he does not need to. But were there no Stock Exchange, no out-of-town brokerage houses, no thousands of miles of brokerage wires spreading like a vast network over the whole country, Jones could not effect his sale so easily and at so fair a price. Lacking all this machinery, he would be forced to go to considerable personal exertion and expense to sell his stock. He would have to talk to his friends and hunt out his friends' friends and perhaps to

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<sup>21</sup> See Appendix VI f.

advertise in the newspapers. It might be months instead of minutes before he would happen upon such a buyer as he can find almost at once through the Stock Exchange, and even then he might have to sell his stock at a heavy discount. Without the work of the stock exchanges the public would indeed hesitate before investing its money in securities which would be so difficult to dispose of afterward.

**Scope of the Stock Market.**—Contemporary fiction to the contrary notwithstanding, there is nothing particularly mysterious about the operation of the Stock Exchange. In its fundamentals it is like any other market, except that it is more completely organized and handles a larger turnover of sales. So huge is the field covered by this market, so numerous are the buyers and the sellers dealing in it, so widespread and efficient are the commission brokerage houses, and so ready are the dealers on its floor, that investors can at any time purchase the prime American investment securities there, or in case of need turn their securities into cash almost immediately. American investors and business men are so accustomed to this instant ability to sell or purchase securities that they sometimes forget the very real and very essential services which the stock exchanges render them.

**True Nature of the Stock Market.**—The average American, of course, is not a member of the New York Stock Exchange. If he sees the operation of this great market at all, necessarily it is not at close hand from the Exchange floor but even at best from a distance in the visitors' gallery. And owing alike to the surf-like roar of many voices which its open-market system makes inevitable, to the swift movements of the many men on its floor, and to its many unique mechanical devices, the impression of the Stock Exchange which he forms from looking down upon it for a few minutes from the gallery is as likely to deepen his doubts and confuse his understanding of its real nature, as to inform him of its actual methods and economic services.

Yet, however confused the spectator's mind may become at it all, the members of the Stock Exchange are so accustomed to the clamor of the market place that they are as a rule neither excited nor confused. As subsequent chapters may partially succeed in establishing, it would require years of patient study and observation, as well as no slight degree of imagination and intelligence, before an observer in the gallery could perceive the stock market below him with adequate knowledge and comprehension. But, as has been once stated,<sup>22</sup> if the onlooker from this vantage point possessed these several and difficult qualifications:

He would see purchases for investments; he would see sales on behalf of persons wishing to convert their securities for one reason or another; he would see purchases and sales for the dealers in odd lots to meet the needs of the small investor; he would see purchases and sales with a purely speculative purpose; he would see the floor trader buying and selling for the profit of the hour; he would see the arbitrageur selling securities that he has bought in London, or Paris, or Amsterdam, or Berlin the same day, or buying here the securities he has sold on a foreign exchange the same day. Every transaction is recorded, and the quotations that go out are the result of all these manifold operations. They are the product of the judgments, temperaments, hopes, fears and doubts of the vast multitude that participate in them. It is a scene of competition; the conservatism of investment face to face with the enterprise of speculation; speculation in the expectation of a rise in prices with speculation in the expectation of a fall; optimism with pessimism; and the resultant of this play of forces is the market price of the securities dealt in moment by moment, hour by hour. The exchange is the crucible in which all these various elements are, as it were, chemically combined and concentrated to produce what we call market values. All these elements are indispensable as supplements and correctives of each other. Eliminate speculation and the conservatism of investment would arrest the development of the country. Eliminate speculation in the expectation of a fall in prices and the danger of inflation of prices would be constant. Without the free interplay of all these forces a market would not perform its function of fixing prices for the purposes of trade and commerce.

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<sup>22</sup> See Regulation of the Stock Exchange, pp. 531-532.

## CHAPTER VII

### CREDIT TRANSACTIONS IN SECURITIES

**Need of Understanding Credit Operations.**—In the preceding chapter it was explained how the machinery of the Stock Exchange enabled one man in Baltimore to sell his stock to another man in San Francisco. This imaginary but quite typical case was, in the instance of both buyer and seller, what is known as an “investment transaction”—a phrase which here refers only to the terms between broker and customer under which the sale was made.<sup>1</sup> It is to be noticed that in the case cited, Jones of Baltimore simply took his stock to his broker and employed the latter to exchange it for money, while Smith of San Francisco took his money to his broker and employed him to exchange it for stock. The element of credit did not enter into either the purchase or sale of the stock in any vital way.

Such outright sales and purchases of stock occur in the Stock Exchange less frequently than purchases and sales of stock which employ credit, just as cash payments and immediate deliveries are the exception rather than the rule in ordinary wholesale commercial practice. Most of the significant economic forces in modern America find a natural and immediate expression in the credit transactions in securities which occur daily upon the floor of the Stock Exchange. Since they are so often misunderstood and misrepresented, a wider understanding of these credit transactions in securities is more than ever imperative.

It is first necessary to consider briefly what a sale really is. Every sale, not merely of stocks and bonds but of any com-

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<sup>1</sup> See Chapter V, p. 125.

modity whatsoever, is simply an exchange of money and goods. For this reason, strange though it may sound, it would from a purely economic standpoint be quite correct to speak of buying \$75 with a ton of steel, or selling \$60 for a suit of clothes. Owing to our constant use of money as the measure for all values, however, we habitually think of every sale in terms of money rather than in terms of goods.

**Sales for Cash and on Credit.**—Sales can be divided into two general classes, depending on whether or not they involve the element of credit. In an outright or cash sale, the buyer immediately pays his money and the seller at once delivers his goods. Since there is no delay on either side of the transaction, credit—which is simply a substitute for money or goods in the form of a promise either to pay the one or to deliver the other at some future time—is in no way involved. Yet cash sales undoubtedly furnish a smaller part of our daily business turnover today than do sales on credit. Indeed, the use of credit had come to constitute a vital factor in business even before the creation of our modern stock exchange or banking systems. If by some economic miracle credit transactions could be wholly abolished, our entire modern financial system would at once degenerate into the crude business of money-changing from which it rose centuries ago. All modern governments, by their issuance of both bonds and fiduciary paper currency, show how completely dependent they are upon the use of credit. As for commerce and industry, neither has been wholly upon a basis of cash payment and immediate delivery since the economic stagnation of the Dark Ages—if, indeed, they were even then. It is, consequently, no exaggeration to say that without the invention of the credit machinery which in modern times permits the deferred payment of money and the deferred delivery of goods, the vast material and spiritual progress of the human race since the twelfth century would have been utterly impossible.



**Fallacies Regarding Credit.**—In spite of the extensive and time-honored employment of credit in business, comparatively few men ever stop to analyze in detail exactly what credit is. In consequence, the average business man is only too apt to be puzzled when he is asked, "How can a man buy something which he doesn't want to keep and when he hasn't enough money to pay for it?" or "How can a man sell something which he doesn't own?" Superficially considered, both of these questions would seem to imply a lack of business morality. And yet the simple answer to both these questions obviously is, "By using credit." Thanks to the vast extension of our credit machinery during the past century, the deferred payment of money and the deferred delivery of goods have both become a daily commonplace, not merely in Stock Exchange transactions, but in every conceivable kind of modern business.

One phase of this universal use of credit deserves consideration at this point. Although a sale is really an exchange of money and goods, our inevitable habit of thinking only on the money side of what is necessarily a two-sided transaction makes it easier for the average man to understand a deferred payment of money than a deferred delivery of goods. Owing someone money is an experience with which, fortunately or unfortunately, most of the human race is only too well acquainted, whereas owing someone goods—whether it be an overcoat, a barrel of molasses, or a share of stock—is apt to seem a novel and highly perplexing situation.

**Debts in Terms of Goods.**—Yet a moment's thought will show that it is no more unnatural to owe goods than to owe money. In ancient times, long before money had been invented, all trading was necessarily conducted entirely by barter, which consists of an exchange of goods for goods. Thus an ancient Roman would exchange his cattle for someone's bronze implements, or an American Indian would barter his furs for another Indian's corn. In point of historical evolution, therefore, it is altogether probable that credit was used to defer a

delivery of goods, long before it was employed in the deferred payment of money. It is consequently apparent that owing someone goods rather than money is not at all a new device of "high finance," but an inevitable and immemorial practice arising from the fundamental nature of trade.<sup>2</sup>

**Purchasing a House on Credit.**—Keeping it constantly in mind, then, that every sale is necessarily a two-sided transaction, involving goods as well as money, let us examine in more detail a typical purchase on credit. Mr. Jones, with a bank account of \$8,000, a salary of \$8,000, and an ability to save about \$3,000 each year, is attracted by a \$15,000 house. Obviously, he has not money enough at present to buy it, nor does he wish to tie up all his savings in it, yet he has every reason to believe that, counting in part of his bank balance, he can comfortably pay the necessary amount in four years. He therefore decides to purchase the house on credit. He puts up \$5,000 of the money he has in the bank, and gives his note for \$10,000 to the seller.

This note is a promise to make a deferred payment of money, and is secured by a mortgage upon the house. If Jones cannot keep up the interest on the note or make the deferred payment on its principal at maturity, the holder of the note can seize the house to recover the \$10,000 involved. But subject to these conditions Jones has the house, and can live in it and enjoy it while he is saving the money needed to complete payment for it. Or, if houses become more expensive and someone offers Jones \$18,000 for his house, he can sell it, and after paying off his note have a profit of \$3,000 on the transaction. The credit element in Jones's purchase of his house is involved on the money side of the transaction. Jones obtains the house when he "hasn't enough money to pay for it" by employing credit to defer the payment of 66% of its price.

**Credit Sale of a Crop.**—Let us now consider a case where credit is used to defer the delivery of goods instead of the pay-

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<sup>2</sup> See Appendix VIIa.

ment of money. Smith owns a fertile farm, where in the past he has grown wheat both successfully and profitably. But early one spring he finds himself without money enough to buy seed and pay for plowing, sowing, and harvesting the next year's crop. It seems a hopeless situation to Smith, as he murmurs to himself those ancient and tragic words, "If I only had the money. . . ." But the affair is not so impossible after all. The fundamental earning power in his dark rich soil is undoubtedly there. And so, perhaps just when Smith is most discouraged, a commission grain merchant who has heard of his dilemma, visits him and offers to buy the crop that Smith is so confident he can raise, before it is even planted.

If this is the first time that Smith ever made such an arrangement, he may perhaps think the whole transaction fantastic and impracticable. Yet the modern machinery for handling such credit operations has rendered them a universally beneficial commonplace in American agriculture. With the money advanced by the merchant, Smith proceeds to purchase seed and do his plowing, sowing, and harvesting. Of course, the transaction has its risks. Smith has sold a wheat crop which as yet he does not possess. Winds, rains, and insects may prevent him from making the deferred delivery of wheat in return for the money advanced him by its purchaser. Nevertheless, without this sale for future delivery Smith would not have been able to raise a crop at all. In the majority of cases both Smith and the commission merchant will find their bargain a profitable one. Other similar examples both of purchases or sales made on credit could, of course, be cited almost indefinitely.

**Use of Credit in Security Transactions.**—Buying and selling securities on credit is no different in principle from buying or selling houses or wheat on credit; neither does one have to go to the Stock Exchange to meet with such transactions. In floating the Liberty Loans our Government employed the buying and selling of securities on credit to a vast extent. In

order to obtain the enormous sums needed for the prosecution of the war, our Treasury Department urged Americans to purchase their bonds on credit by making an initial payment themselves, and allowing the banks to furnish them credit for the balance of the price of the bonds. In this way subscribers were able to buy more bonds than they would otherwise have been able, and by gradually paying off with their savings the credit furnished by the banks, they were finally able to obtain complete ownership of their bonds.

The Government also made a deferred delivery of most of the bonds which it sold. When the subscriber for cash deposited his check at his bank, he was told that the bonds which he was buying were not yet ready to deliver—that they had not yet even been printed. Minus his money and at the same time without his bonds he walked out of the bank, perhaps in a puzzled state of mind. The delayed delivery of the bonds was, of course, necessitated by the enormous task of engraving and printing them. The Government consequently employed its credit in agreeing to deliver the bonds at some convenient future time in exchange for the subscriber's cash and his banker's money credit. When the subscriber received his bonds, he no doubt proceeded to forget—if indeed he had ever completely realized it—that the Government had sold its securities to him on credit and for future delivery.

**Financial Terminology.**—Now every profession has its own technical "lingo" which, however necessary, usually leads to considerable confusion in the public mind. Many simple incidents in business, when paraphrased by the lawyer, suddenly become mighty and perilous affairs indeed. Common ailments, described with the lengthy Greek derivatives of the doctor, grow into mysterious and fearsome diseases. Much the same thing occurs when such ordinary business operations as selling or buying on credit are referred to by the banker or broker in their financial argot as "buying on margin" or "selling short." The needless mystery which these mere words

create about our stock markets largely explains why it is that certain newspapers and magazines which year in and year out accept the yearly subscription price for their journals in exchange for their promise to complete the deferred delivery of them to the subscribers a whole year afterwards, will so often express horror at "short sales" on the Stock Exchange, because, forsooth, they involve "selling what one doesn't own."

**Purchasing Securities on Credit.**—In actual fact, then, "buying on margin" is simply the financial phrase for purchasing securities by employing credit to defer a payment of money; the same basic operation is known as "purchasing on credit" in some branches of commercial business. "Selling short," on the other hand, is simply the phrase used in finance to designate a sale of securities in which credit is used to defer their delivery; in its economic essentials this operation corresponds to what merchants and manufacturers often call selling for "forward" or "future delivery." An investor or speculator who has bought stocks on margin is said to be "long" of stocks; whereas if he has sold them but has not yet delivered them, he is said to be "short" of stocks. Furthermore, the speculator who buys stock on margin in the expectation of seeing a rise in its price which will subsequently enable him to sell it at a profit, is called a "bull," while the name of "bear" is given to anyone who sells a stock short in the anticipation that its price will shortly decline so that he can buy it to "cover" his sale (i.e., make his deferred delivery of the stock) at a lower price and obtain a profit.

Thus Stock Exchange transactions, when stripped of the hectic and unfamiliar verbiage with which the financial scribe so often invests them, resolve themselves into a few commonplace and immemorial practices of trade which exist just as extensively, although unhonored and unsung, in every grocery store and newsstand in the nation.

**Margin Purchase of 100 Steel.**—That the principles involved in purchasing securities on credit are fundamentally



identical with those involved in the purchasing on credit of any commodity, is at once apparent when we examine in detail a typical purchase of securities on margin as it is carried out through the machinery provided by the Stock Exchange.

Let us suppose that just as Mr. Jones was about to purchase his house on credit, a relative had died and left him a house and that he had therefore resolved to invest the same amount of money, present and prospective, in securities instead. After some deliberation, Jones selects U. S. Steel common stock—let us say—as a security yielding satisfactory dividends and likely to advance in price. Having thus become a “bull” on Steel, he goes to his broker, a member of the New York Stock Exchange, and requests his assistance in purchasing 100 shares of Steel on credit. Steel is selling at 150, and consequently the cost of 100 shares will be \$15,000. Jones puts up \$5,000 in cash as a part payment (or, as the financial phrase runs, a “50-point margin”), while his broker agrees to obtain credit for Jones for the remaining \$10,000 needed to purchase the stock. The broker may loan Jones this \$10,000 out of the funds of his own firm, or he may obtain that sum from a bank as a loan negotiated for and contracted in the name of his brokerage firm.

In order to secure the loan, the broker will demand the right to hold Jones's certificate for 100 shares of Steel when it is purchased.<sup>3</sup> In case the loan has been obtained from a bank, he is in turn obliged to allow the bank to hold the certificate until the loan has been paid off. Jones must, of course, pay interest on this \$10,000 which he has borrowed. Meanwhile Jones is the owner of the 100 shares of Steel and is entitled to all dividends declared on it, which in normal times should roughly cover the interest charges on the borrowed funds involved by the transaction. Furthermore, if the price of Steel should climb upward to 170 and he should sell his 100 shares for \$17,000, after paying off his loan of \$10,000 and recover-

<sup>3</sup> See Appendix IVI, and Chapter XI, p. 282.

ing his "margin" of \$5,000, he would obtain a profit on the transaction of about \$2,000.

**Duties of the Broker.**—In stock purchases of this kind, the broker of course demands and deserves ample protection. The actual purchase of stock on the floor of the Exchange, as well as any loan which he may subsequently obtain upon it at the bank, are both contracted for in the broker's name. Consequently, in case of the unwillingness or inability of the customer to "carry" the stock, as well as the loan and the interest upon it, his broker must do so. The broker's only profits in a 100-share transaction in a stock selling around \$150 a share consist of his commission of \$25 for buying the stock and \$25 for selling it (or, for both transactions, about  $\frac{1}{3}$  of 1% of the value of the stock), plus the interest on \$10,000, in case the broker advanced this money to Jones to make the purchase. In case the broker obtained the \$10,000 for Jones from a bank, he will charge a slight addition to the rate of interest demanded by the bank to compensate him for the trouble, expense, and responsibility he assumes in obtaining the money. The broker is acting simply as Jones's agent. Since he will not share in any speculative profits which Jones may make in the transaction, he cannot be expected to share any more of the speculative risks involved than he can help.<sup>4</sup>

The principal risk taken by a broker when his customer purchases stock on margin is that the cash value of the stock on the market may decline below the amount of money originally borrowed to purchase it. If, for example, Jones's 100 shares of Steel should decline from 150 to 95, their value would shrink from \$15,000 to \$9,500, or \$500 less than the \$10,000 loan originally made to purchase them. If meanwhile, the broker was so foolish as not to call upon Jones for more margin, he would find himself liable for the \$10,000 loan, with only \$9,500 worth of stock to secure it. To protect himself against possible losses of this kind, the broker will therefore

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<sup>4</sup> See Chapter XV, p. 416.

demand that his customer put up more margin whenever the market value of the latter's stock declines, so that there will constantly be a reasonable surplus when the purchase price of the stock is subtracted from its market value plus the customer's margin. Since the purchase price of the stock is fixed at \$15,000, it is obvious that the less the stock is worth on the market, the more margin the customer must put up to maintain this surplus.<sup>5</sup>

There is no uniform rule regarding the exact percentage of margin initially required, or the extent to which a broker will carry his margin customer in a declining market before calling upon him for additional margin. The credit of individuals varies so widely that brokerage houses, just as banks, must decide each case involving an extension of credit on its own separate merits. It is, however, a well-recognized fact that it is to the advantage of both broker and customer to establish and maintain adequate margins, and that the most successful brokerage houses are apt to be those which are most conservative about margin requirements. The Constitution of the Stock Exchange (Rules, Chapter XII, Sec. 1) states: "The acceptance and carrying of an account for a customer, whether a member or a non-member, without proper and adequate margin, may constitute an act detrimental to the interest or welfare of the Exchange."

**"Margin Calls" and Profit-Taking.**—But to return to our example: If the price of Steel declines to 125, the broker may demand that Jones put up an additional \$2,500 of margin, since the 25-point decline has reduced the surplus of the value of the stock plus the margin over the purchase price to only \$2,500. In case the stock continues to decline, and Jones, after being notified by the broker, refuses to put up the amount of margin thus requested, the broker may then sell his 100 shares of Steel at—say—110. Out of the \$11,000 resulting from the sale he will then pay off the \$10,000 loan and return \$1,000

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<sup>5</sup> See Chapter XV, p. 430.

to Jones, minus interest charges, brokerage commissions, and stamp taxes.

If, however, the expected rise in the price of Steel occurs and the stock sells at 165 on the market, Jones's margin has increased by \$1,500. But perhaps Jones decides to conclude the transaction and "take his profit." The broker, on Jones's instructions, then sells the 100 shares of stock for \$16,500 and, after paying off the loan of \$10,000, returns to Jones \$6,500 minus brokerage commissions, interest charges, and stamp taxes. Thus Jones, in addition to recovering his original margin of \$5,000, obtains a profit of almost \$1,500 in the transaction.

**Selling for Deferred Delivery.**—Since every sale is simply an exchange of money and goods, it is obvious that the factor of credit can become involved in a sale in two different ways—either through a postponement in the payment of money or in the delivery of goods. Respecting transactions in the stock market, we have briefly considered the practice of deferring the payment of money known as "buying on margin." We must next examine "short selling," which involves the deferred delivery of stock.

The position of the man who sells stock short is fundamentally identical with that of the farmer who sells his crop before it is planted, or of the publisher who sells his newspapers months before the events which they will chronicle have even occurred. All these three sellers, by employing their credit and deferring the delivery of their goods, sell something which for the time being they do not own, but which they feel confident they can obtain. All three owe goods instead of money, and, to conclude their sales on credit, all three must depend upon obtaining later the articles which they have sold—a task which may be either harder or easier than to obtain an equivalent sum of money.

Attention has already been called to the fact that because of our almost universal habit of thinking of sales in terms of

money rather than in terms of goods, owing goods is apt to seem to the average man much more dangerous than owing money. Let us follow through its various stages, a typical short sale of stock occurring on the New York Stock Exchange, and see if this practice is the evil and nefarious thing which many sincere but superficial critics of the stock markets would have us believe.

**Selling 100 Corn Products Short.**—Thompson, who is a "bear" and anticipates declining prices, instructs his brokers, White & Co., to sell 100 shares of Corn Products stock short for him at 100. Thompson does not possess this stock, but can, of course, buy or borrow it whenever he so desires. Before proceeding to execute this order, the brokers must not only have confidence in Thompson's financial responsibility, but will probably insist on possessing tangible evidence of it in the form of a margin of—say—30 points, or \$3,000, to protect themselves against the unwelcome possibility of a rise in the price of the stock to be sold. It is also understood between Thompson and White & Co. that in case Corn Products stock should advance in price, Thompson will maintain this 30-point margin by putting up more margin, so that a surplus of \$3,000 shall always remain after the current purchasing price of the stock has been subtracted from the price of \$10,000 at which it was sold plus the customer's margin. As in the case of a margin purchase, the broker in the event of an upward movement in the value of the stock will demand that Thompson put up a proportionate amount of additional margin, while if the price of the stock declines, Thompson's margin will be increased to that extent. Also, in case Thompson does not furnish the additional margin when this becomes necessary and is requested by his broker, the latter will proceed to buy 100 shares to conclude the transaction and return to his customer what remains of his margin. In a short sale the customer is not called upon to pay interest charges, since he is not borrowing any money. But, as we shall see, he must expect



to pay such dividends as may be declared upon stock of which he is short and which he has to borrow.

**The Purchaser's Attitude.**—With these preliminaries arranged, White & Co. proceed to sell for Thompson 100 shares of Corn Products on the floor of the Stock Exchange to Brown, another broker, at 100. Brown, the buyer, does not know or care whether White's customer is selling outright or on credit. He has made an agreement on the floor of the Exchange to pay \$10,000 for 100 shares of Corn Products. Unless he pays for the stock by the next day, he may be subject to the severe penalties imposed by the Stock Exchange when a broker fails to meet his obligations. Furthermore, he knows that White & Co. are under the same compulsion to deliver to him the 100 shares of Corn Products by the same time. Where White & Co. will get this stock is no concern of his.

Meanwhile White & Co. have assumed the responsibility of delivering by 2:15 P.M. of the next day, stock which they do not possess.<sup>6</sup> It may happen that Corn Products declines to 95 that same day, thus permitting Thompson to buy 100 shares at this price and make a profit of 5 points—or \$500—minus commissions, etc. If this is done, White & Co. can deliver to Brown by the next day, the stock thus purchased and so obviate any further difficulty in the transaction. Yet in a majority of cases, stock which has been sold short will not decline quite so conveniently. Probably, then, Thompson will wish to remain short of the stock for some time.

**Function of the "Loan Crowd."**—To avoid just this dilemma which brokerage houses would otherwise experience in making deliveries of stock which had been sold short by their customers, a system of borrowing and loaning stocks has developed on the floor of the Stock Exchange, which is a counterpart of the system also developed there for borrowing the "call money" with which the margin purchases of brokers'

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<sup>6</sup> See Chapter XII, p. 312.

customers are regularly financed. Some mornings as early as 9:45 A.M., the "loan crowd" assembles on the floor, and within it the loaning and borrowing of stocks may go on intermittently till 1:30 P.M.; no loans are made between 1:30 P.M. and 3:00 P.M.; most if not all of the day's loans are made between 3:00 P.M. and 3:30 P.M.

This loan crowd is composed of Exchange members who wish to borrow or loan stocks. White & Co.'s Board member—i.e., the particular partner in the firm who is a member of the Exchange and who handles its business on the floor—therefore seeks out Green, a broker with 100 shares of Corn Products to lend. To obtain the loan of Green's stock, White & Co. usually have to agree to lend Green a sum of money equal to its market value. If, for example, Corn Products closed that day at 100, Green will obtain a loan of \$10,000 in return for the loan of the stock which he makes to White & Co. It is understood between such lenders and borrowers of stock that the amount of this money loan must be kept at a figure equivalent to the market value of the stock in question. Should Corn Products rise from 100 to 105, White & Co. would have on his demand to loan to Green an additional \$500 upon it; while if the stock should decline from 100 to 95, Green would have on their demand to return to White & Co. \$500 of the original loan of \$10,000.

Thus Green borrows White & Co.'s money and White & Co. borrow Green's stock. But the money still belongs to White & Co., and the stock to Green. For this reason, Green must normally pay interest on the money borrowed from White & Co. On the other hand, White & Co. must pay to Green such dividends as may be declared upon the stock borrowed from him.<sup>7</sup> Of course, Thompson, as a principal, must in turn repay these dividends to his agents, White & Co.

This necessity of the short seller to pay for dividends in this way, which often puzzles inexperienced traders and in-

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<sup>7</sup> See Chapter XV, p. 427.

vestors, has been likened to the case of farmer X who loans his cow to farmer Y. If in the course of this loan the cow has a calf, it naturally belongs to X, the owner of the cow, and not to Y, who is simply the borrower of the cow.

**Loans Made "Flat" or "at a Premium."**—While the above arrangement between the borrower and the lender of stock is typical, its details may vary considerably because of conditions connected with the supply of and demand for the stock in question in the "loan crowd." If Corn Products shares grow scarce, Green will demand and obtain a low rate of interest on his loan of money, or he may get the loan of money "flat"—that is, without having to pay any interest on it at all. In cases of extreme scarcity of stock he may even obtain, in addition to his loan of money without interest, a cash premium from the borrower of his stock. Of course, this premium is in turn charged by the borrowing broker to his customer who has gone short of the stock in question.<sup>8</sup>

Returning to our example, White & Co. deliver the 100 shares of Corn Products borrowed from Green to their purchaser, Brown. The latter in turn pays to White & Co. their selling price of \$10,000. Broker Brown, therefore, having paid his money and received his stock, is now out of the transaction. There remain involved in it Thompson (who owes White & Co., his brokers, the 100 shares of stock), White & Co. (who owe Thompson his margin of \$3,000 and \$10,000—the selling price of the stock—and who owe Green the 100 shares of stock), and Green (who owes White & Co. \$10,000, and who is owed the 100 shares of stock by White & Co.). Green is protected for his loan of stock by the money he borrows from White & Co.; White & Co. are protected in their debt of stock owed to Green by Thompson's debt of stock to them and his margin. Thus, since Thompson alone can make

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<sup>8</sup> *Ibid.*, p. 427.

any speculative profit in the transaction, its speculative risks are placed squarely up to him.

**"Short Covering."**—Sooner or later Thompson will wish to conclude the transaction, which from his standpoint may or may not have been successful. If unsuccessful, he may lose a part or perhaps the whole of his margin. Let us, however, suppose that the price of Corn Products has sunk from 100 to 90. Thompson, in order to take his profit, instructs White & Co. to buy 100 shares of the stock to cover his short sale (i.e., make his deferred delivery of stock). White & Co. buy the 100 shares at 90 and turn them over to Green, who promptly returns the money he has borrowed (then probably amounting to about \$9,000) to White & Co. Thus Green, having recovered the stock he loaned and paid back the money he borrowed, is eliminated from the transaction, leaving only White & Co. and their customer Thompson, still involved in it. The debt of stock which Thompson owed White & Co. and which the latter owed Green, has, as we have seen, been all wiped out by the delivery made to Green. Thompson, apart from his original margin of \$3,000, had a credit on White & Co.'s books for \$10,000 (the original price of the stock), and after paying out \$9,000 to purchase the 100 Locomotive has, in consequence, in addition to the original \$3,000 margin, a profit of \$1,000 minus brokerage commissions, dividends paid while the short sale was still unconcluded, and stamp taxes. And thus Thompson's whole short sale terminates.

#### **Reciprocal Nature of Short Sales and Margin Purchases.**

—Some critics of stock market transactions, while conceding the necessity for purchasing stocks on margin, still believe that short sales should be forbidden. This attitude of mind is the more remarkable when it is realized that every purchase of stock on margin simultaneously causes a short sale of money, and, conversely, that every short sale of stock inevitably causes a margin purchase of money.

We have seen how Jones bought his Steel stock on a 50-point margin. In obtaining more stock than he paid for, he employed \$10,000 which he did not own. Since in effect he obtained value in stock for money he did not own, exchanging it for 100 shares of Steel, he thus sold money short and became long of stock.

Also, when Thompson sold 100 shares of American Locomotive short, he received a credit on his broker's books for \$10,000, in addition to his margin of \$3,000, to balance the debit of the 100 shares of stock. Consequently, although perhaps he did not think of it in just this way, he really bought money on margin at the same time that he went short of the stock.

**Fluctuating Values in Goods and in Money.**—Since the value of goods is so invariably expressed in terms of money, it is difficult to realize that the value of money itself, like any commodity, constantly fluctuates.<sup>9</sup>

Because a margin purchase of goods inevitably produces a short sale of money, the margin purchase and the short sale are inseparable operations in any market in which credit transactions occur. If it is an evil deed to sell stocks short, then it must be equally wicked to sell money short. And, if we cannot purchase any commodity on margin without selling money short, then all credit transactions must be wicked. Thus the logical outcome of driving the wild asses of mistaken ethics into the field of financial economics, is a return to the Dark Ages, when there were not only no wicked credit transactions but no business, law, order, or civilization either.

**Twofold Aspects of Margin Purchases.**—The somewhat complicated results arising from this double nature of credit transactions may be summarized by saying that whoever purchases stocks on margin has a double chance for profit and a double chance for loss in the transaction. As we have seen in the instance of Jones and his 100 shares of Steel, if the price

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<sup>9</sup> See Appendix VIIb.



of Steel rises he obtains a profit, and if it declines he takes a loss. But in becoming long of stock, he has also gone short of money. Consequently, if the value of money advances he will tend to suffer a loss; while if it declines he will tend to profit. In the first case, the rising interest rate on call and time loans may make Jones's transaction too expensive to be profitable, and he will probably "liquidate," as it is called, by selling out his stock for what it will bring. Usually, the result of such liquidation by many margin purchasers will be to force down in turn the price of the stock itself.

On the other hand, if the interest rate declines, it will assist the margin purchaser to obtain a profit, since he will be directly responsible for smaller interest charges on his loan (which often may be offset by dividends paid on his stock) and since a lower "call rate" will often induce greater margin buying by others, which in turn tends to raise the price of the stocks he has purchased.

**Twofold Aspects of Short Sales.**—Short sales of securities are in the same way subject to a loss or a profit, both on the money and the stock side of the transaction. We have seen that Thompson obtained a profit if Corn Products declined in price, and stood to lose if it advanced. But conditions in the money market may also mean a profit or a loss to him, since in going short of stock he has also gone long of money. An advance in the call rate of money is, therefore, favorable to him, since his broker White can often obtain from Green a higher interest rate on the money loaned to the latter in return for the loan of his stock. Also, as has been pointed out, a rising rate in call loans is apt, through forcing liquidation by margin purchasers, to depress the price of stocks, by which development Thompson, of course, profits. On the other hand, a declining interest rate may result in the interest on White's loan of money to Green becoming smaller than the dividends which Thompson must pay on the stock Green loaned to White, and since a declining call rate is also apt to result in rising stock

prices by encouraging margin purchasers, the chances are that Corn Products will rise rather than decline in price.

**Stock Prices and the Money Rate.**—So many factors enter vitally into the establishing of stock prices that the influence of the call rate upon them is frequently offset by some counterforce. In some of the duller periods in stock market history, although call funds were ruling as low as 2%, nevertheless dividends on stocks had been proportionally reduced, with the consequence that stock prices also remained very low despite the prevalence of "cheap money." Yet, other factors being equal, the result of changes in the call rate on stock prices will be as stated above, and thus forcibly demonstrate that every margin purchase of stock presupposes a short sale of money, and that every short sale of stock presupposes a margin purchase of money.

As methods of purchase and sale, the margin purchase and the short sale are, therefore, inseparably and reciprocally connected, like the two sides of a coin, owing to the fundamental fact that every sale is and must be a twofold operation involving both money and goods. The illogic of attempting to restrict short selling, and at the same time to permit margin purchasing or any use of credit in dealings, is thus apparent.

**Shortages of Money.**—Since every margin purchaser of stock assumes a debt of money and every short seller a debt of stock, it is obvious that a shortage of money<sup>10</sup> may seriously hinder the former from making his deferred payment, while a shortage of stock may similarly embarrass the latter in making his deferred delivery. These shortages of money and stock are risks inevitably involved by credit transactions in the stock market.

While an examination of the "call loan" system employed to finance margin purchasers of stock must be deferred to a later chapter,<sup>11</sup> some few of its features deserve comment here. The Stock Exchange has no control over the shortages which

<sup>10</sup> See Appendix VIIc.

<sup>11</sup> See Chapter XI.

occasionally develop in the money market, for, as we have already seen, its members usually go to the banks when they need funds, just as any other customers of the banks do. The banks, in turn, can only minimize, without being able to prevent, these shortages of money, which are normally produced by far-reaching and profound economic causes, not merely in all parts of our own extensive country but all over the world. The Stock Exchange, however, has for a long time endeavored to prevent violent fluctuations in call loan interest rates which result from a surplus or a shortage of funds in the money market.

**Efforts to Prevent "Corners."**—The Stock Exchange is equally anxious to prevent any shortage of stock, since this may result in a "corner." Its Committee on Stock List, to begin with, makes a thorough examination of the distribution of the stock of every company that applies to list its securities on the Exchange, in order to prevent trading in any stock which is largely held by a single individual or interest.<sup>12</sup> Its Committee on Quotations, through the extensive ticker service under its supervision, sees that almost instant and nation-wide publicity is given to transactions in all securities listed on the Exchange. Furthermore, once it is clear that a corner has developed in any listed stock, the Governing Committee of the Exchange promptly prevents further trading in it on the Exchange by striking it from the list. In every such case, the interest of the Stock Exchange is identical with that of the public in maintaining on its floor a market for securities which shall at all times be free and open. In spite of occasional exceptions, it is rare that an acute shortage of either money or stock really arises on the Stock Exchange.

Thus we see that, as operations, margin purchases and short sales are identical with the purchases or sales on credit which are of universal occurrence in every line of modern business, which have on the economic side powerfully and profoundly

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<sup>12</sup> See Chapter IV, p. 107, and Appendix VIIId.

furthered human progress in the past few centuries, and without which (as even the Bolsheviki in Russia discovered) not merely the luxuries, conveniences, and comforts, but even the barest necessities of life cannot be daily afforded to mankind. It has furthermore been shown that margin purchases and short sales are reciprocal and presuppose each other, for if we cannot sell (or exchange) what we do not possess, we can never buy more of anything than we are able to pay for.

The question then arises whether the economic results flowing from the employment of these methods of purchasing or selling on credit, however legitimate they may be as mere methods, are beneficial or desirable.

**Use of Credit for Investment Transactions.**—In this connection one fact infrequently recognized is that neither margin purchases nor short sales of stocks are necessarily undertaken for speculative purchases. In many cases, where the investor wishes to purchase stocks outright for cash, the broker, who of course cannot tell at exactly what price the required shares can be purchased, may ask him to deposit 50% of their latest price and pay the balance after they have been purchased. Such a practice is essentially a purchase on credit, even if it is not commonly called a "margin purchase" in Wall Street. Similarly, the owner of 100 shares of Steel may desire to sell them at a time when he is in London or San Francisco, and his shares are securely locked up in his New York safe deposit box. Under such circumstances he may instruct his broker to sell 100 shares of Steel short, and cover the short sale on his return to New York by getting his stock from his box and delivering it to his broker. Thus margin purchasing and short selling may be and often are employed as conveniences in what are essentially outright purchases and sales.

Furthermore, were it impossible to buy and sell stocks on credit, the odd-lot dealer, whose business consists of purchasing or selling from 1 to 99 shares of all listed stocks, could not carry on his useful work.<sup>13</sup> The odd-lot dealer is constantly

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<sup>13</sup> See Chapter IX, p. 233.

forced to take a long position of stocks in 100's, by purchasing the various odd lots which customers may sell to him at all times, and to take a short position in 100's by selling customers any number of shares they may wish. Of course the odd-lot dealer ultimately sells in 100-share lots the stock which he has accumulated by his odd-lot purchases, and he ultimately covers his short sale of odd lots by purchasing in 100-share lots. Yet it is obvious that if purchases on credit or short sales were forbidden, the odd-lot dealer could not successfully carry on his considerable and essential business in enabling small investors to sell or purchase readily.

### **Speculative Nature of Margin Purchases and Short Sales.**

—For all the above instances, however, and many others of a similar nature, it is of course undoubtedly true that the vast majority of both margin purchases and short sales are made purely for the sake of obtaining a speculative profit through buying at a lower and selling at a higher price. The broader aspects of speculation as an economic phenomenon have already been treated.<sup>14</sup> Speculation will therefore be considered here only in so far as it finds practical everyday expression through the margin purchase and the short sale.

Every so often, some native Solon will obtain a half-column in the papers to declare that stock speculation, particularly that of "bears" who sell short in the anticipation of declining stock prices, is injuring the intrinsic value of our railroad and industrial companies. Some indignant critics, indeed, openly state that short selling destroys the companies' property, and picture the "bear raider" as a sinister villain who delights in the ruin of other men's goods by some mysterious means in the stock market. The sheer nonsense of such statements is of course apparent to anyone who knows anything at all about stock market transactions—a knowledge which, paradoxically enough, these critics of stock exchange speculation often hasten to disclaim at the outset.

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<sup>14</sup> See Chapter V.



**Effect of Short Sales on Values and on Prices.**—A share of stock is simply a certificate of fractional ownership in the assets and earning power of some corporation. Let us suppose that some bear trader, believing that the shares of a copper company are selling higher than they should, sells enough of these shares short to depress their price temporarily 2 points. By this operation he has not decreased the amount of copper in the company's mines, nor injured its mining or smelting machinery. Neither has he affected in any way the industrial demand for the company's products, nor its earning power. The effect of his short sale has been to decrease for the time being, not the inherent equities of the company, but merely the price of its shares, which are only the warehouse certificates to these assets and earning power.

Thus it is apparent that the fundamental and intrinsic value of a given share of stock may be a wholly different thing from the price at which it can be bought and sold in the market at any given time. If it were easy to determine exactly what the present and prospective value of a given stock was, there would be as little speculation in stocks as there is in bonds. But the prospective earning power of any corporation depends upon so many constantly changing economic circumstances that the inherent value of its shares cannot be infallibly determined. The market price of such shares, therefore, is simply a composite estimate reflecting the opinions of the keenest students of industry and finance all over the country.<sup>15</sup> The "bear raider," as he is sometimes picturesquely but rather inaccurately called, may by his short sales depress prices for a time, but he can no more destroy intrinsic values than he can lower the temperature by putting ice on the thermometer bulb.

**Effect of Purchases and Sales on Prices.**—Every purchaser of a commodity, whether of stocks or of "shoes and ships and sealing-wax," tends to raise the price of that commodity, since he tends to increase the demand for it and de-

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<sup>15</sup> See Chapter II, p. 47.

crease the supply of it. Conversely, every seller tends to lower prices by increasing supply and decreasing demand. These laws operate in the establishing of prices utterly irrespective of whether purchases or sales are made outright or on credit. The outright purchaser of 100 shares of Reading tends to raise the price of this stock just as much as a margin purchaser of the same amount, and an outright seller tends to depress its price just as much as a short seller, if they sell the same amount of stock.

But there is this difference, as regards their effect upon prices, between purchases and sales made outright and those made on credit. The outright purchaser tends more permanently to increase the price of the stock he purchases, since he usually withdraws for a long period a number of shares from the supply. Also, the outright seller tends more permanently to depress stock prices, since in most cases he does not soon buy back his stock. Credit transactions in stocks, however, almost always involve both a purchase and a sale. The buyer on margin must ultimately prove a seller before he can obtain his profit, and for the same reason the short seller in the end must buy stock. Moreover, both margin purchases and short sales must usually be terminated within a reasonably short period, lest interest charges and dividends eat up all hope of profits. In consequence, it is obvious that the buyer on margin at first tends to raise prices and later to lower them; and that similarly, the short seller for the time being tends to lower prices, but later to raise them again. Thus a double check is created against the undue inflation of the price above, or the undue depression of prices below, the actual value of any security in which active speculation occurs on the Stock Exchange.<sup>16</sup>

**Automatic Checks Against Inaccurate Prices.**—Let us suppose that the actual inherent value of 1 share of U. S. Steel common stock is really \$150. Should the price of this stock rise to 175—or higher than its value warranted—the margin

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<sup>16</sup> See Chapter II, p. 47.

buyers who had originally bought their stock at lower prices would begin to take their profit by selling at this price. Also, speculators who believed that 175 was more than Steel common was really worth, would sell the stock short. Selling from this double source would soon tend to depress the price of the stock toward its real value of 150.

If, however, Steel common should be selling at 125, these corrective forces set in motion by speculation would also tend to bring up the price nearer to the real value of 150. Previous short sellers would begin to purchase at the low figure of 125 to cover their short sales and obtain their profit, while buyers on margin, encouraged by the belief that the stock was selling under its real value, would begin buying it "for the rise." And this buying, both from the optimistic bulls and the previously pessimistic bears, would of course tend to lift the price back toward its real value of 150. Thus speculation through margin purchases and short sales normally prevents the wide and violent price fluctuations which would result if stocks were removed from the price-registering machinery of the stock exchanges.

**Economic Value of Short Covering.**—Particularly in times when panic is threatening does the "short interest"—i.e., the speculators who have sold short and who are waiting to purchase and cover—perform a valuable service to investors by supporting the falling market with their buying orders and thus helping to hold prices up even in the face of disaster. For at such times the investor and margin purchaser become extremely timid and thus the previous short seller, who is under compulsion to purchase and cover his sales, alone enables the investor who must liquidate, to sell his securities.

Writing of conditions prevailing on the New York Stock Exchange at the outbreak of the Great War in 1914,<sup>17</sup> the president of the Exchange declared:

The conditions on the Stock Exchange when the storm burst, were in some respects very hopeful . . . the unsettled business outlook

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<sup>17</sup> Noble, "The New York Stock Exchange in the Crisis of 1914," pp. 5-6.

due to new and untried legislation had fostered a heavy short interest in the market, thereby furnishing the best safeguard against a sudden and disastrous drop. This short interest was a leading factor in producing the extraordinary resistance of prices in New York which caused so much favorable comment during the few days before the closing (of the Stock Exchange). It were well if ill-informed people who deprecate short selling would note this fact.

On the other hand, the violence of the 1929 stock panic can be largely attributed to the remarkably small short interest in the stock market.<sup>18</sup>

**Stabilization of Security Prices.**—In conclusion, therefore, it may be said that the effect of margin purchases and short sales is really to stabilize prices, that this result is beneficial to both buyers and sellers, and that in an economic sense the undue inflation of prices above values is just as dangerous to everyone concerned as their undue depression below values. If, therefore, short selling were prevented, an effective check would be removed from an upward trend of prices which in the long run would be bound to fall again with a crash, while the support to prices which a short interest provides in just such a declining market would also be removed.<sup>19</sup>

**Legislation Against the Short Sale.**—The popular misunderstanding and prejudice against short selling of securities is not new. As long as the stock exchanges of the world have existed the short sale has been bitterly condemned, but invariably indorsed after thorough investigation or painful experience, as a vital and indispensable factor in the maintenance of free securities markets everywhere.<sup>20</sup> As an operation necessary in organized speculative markets it has, therefore, stood that hardest of all tests—the test of time. Short selling was forbidden in England by Sir John Bernard's Act in 1733; yet this law failed to halt the practice, and in 1860 it was repealed.

<sup>18</sup> See Appendix VIIe.

<sup>19</sup> See Appendix VIII f.

<sup>20</sup> See Appendix VII g.

Similar English legislation later adopted to prevent short selling of bank stocks has also been more honored in the breach than in the observance.

Such, too, has been the experience of France. Napoleon I was dissuaded from forbidding it only by his Finance Minister; later on, the French did legislate against the practice only to repeal the law after its futility and harmfulness were clearly shown. The state of New York has tried the same experiment and with the same result; it prohibited short sales early in 1812, only to remove the ban against them in 1858. Last but not least is the example of Germany. In 1896 a stringent regulation of the Berlin Boerse (or Stock Exchange) was undertaken by the government and again short selling was forbidden, to be reinstated by the repeal of this legislation in 1909. But a famous American economist has stated:<sup>21</sup>

Finally, the effect of interference, increased cost, and legal uncertainty (entailed by this restriction of stock transactions) was to drive business to foreign exchanges and diminish the power of the Berlin Exchange in the field of international finance. The number of agencies of foreign houses increased four or fivefold, and much German capital flowed to other centers, especially London, for investment and speculation. This in turn weakened the power of the Berlin money market, so that even the Reichsbank has at times felt its serious effects.

So long as optimists are more popular than pessimists, buying on margin will doubtless seem to many people a more beneficial operation than short selling. So long as men think on the money rather than the goods side of sales, short selling will doubtless remain more mysterious to the public than margin purchasing. So long as the fallacious benefits of inflation can claim a popular following, whatever tends to lift prices above values will continue to be generally judged preferable to whatever may depress them below values. And thus, while perhaps human nature will always condemn the short sale, genuine economic utility will invariably favor its employment.

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<sup>21</sup> Emery in "Regulation of the Stock Exchange," p. 828.



## CHAPTER VIII

### THE FLOOR TRADER AND THE SPECIALIST

**Function of Dealer in Maintaining Continuous Market.**  
—In Chapter VI we saw two commission brokers, Jenkins and Wilkins, meet at the Steel post and conclude a sale of 100 shares of U. S. Steel common stock. This stock was purposely selected in that imaginary transaction, since its comparatively broad and continuous market often permits of just such transactions between commission brokers. In less active and steady stocks, however, it might be impossible for one commission broker to effect a trade directly with another. Commission broker Jenkins might obtain his order in such a stock and proceed to the post where it was listed; but the chances are he would not happen to find another broker like Wilkins waiting there to buy his customer's stock at just that time, or at a mutually satisfactory price. Of course, it takes two to make a bargain in the Stock Exchange as elsewhere, and if Jenkins cannot find a buyer he cannot sell his customer's stock. As a matter of fact, if Exchange commission brokers could sell only to other commission brokers, cases would constantly arise where sales could not be effected for very considerable periods of time, with the result that listed securities on the Exchange could not possibly possess their present negotiability and comparatively small daily fluctuations in price.<sup>1</sup>

In the process of obviating such inability on the part of commission brokers to sell or to buy immediately at a price, several classes of dealers have arisen on the floor of the Exchange, who, in the absence of a broker with just the right sort of order, stand ready to intervene in such transactions, and at

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<sup>1</sup> See Appendix VIIIa, and Chapter II, p. 48.

their own risk "make a market" for the stock in question. In the main, the work of these dealers is speculative—as indeed the work of a dealer of any sort is bound to be. They will buy stock from a broker at a slight concession, or sell it to him at a slight advance, on their own responsibility and in the hope of obtaining a profit later through the sale or purchase of the stock, as the case may be. When, for example, Jenkins goes to the post where U. S. Rubber stock is traded in with a customer's order to sell 100 Rubber at 50 and finds no broker ready to purchase from him, a dealer may buy his stock, and a little later, if fortune favors, sell it for a slight profit. Dealers are fundamental to all markets in the world, and it could only be due to artificial conditions if we did not find them equally necessary to the continuous market made for securities on the floor of the Stock Exchange.

**The Floor Trader.**—One of the most important types of dealers on the Stock Exchange is the so-called "floor trader." He is a professional speculator who trades in stocks for small, quick profits. Being a member of the Stock Exchange, he can execute his own orders and thus escape paying commissions, which the speculating non-member customer in a broker's office must pay. For reasons presently to be explained, the number of Exchange members ordinarily operating as floor traders is today much smaller than before the war.

A graphic sketch of the typical floor trader has been given by a former governor of the Stock Exchange:<sup>2</sup>

These gentlemen afford an interesting study. They do not accept orders; each man is in business for himself. They entertain no illusions, and they recognize no alliances with each other. Each one follows his own inclinations, and does not permit himself to be moved by tips, or rumors, or gossip, or sentiment. He scoffs brazenly at all forms of "inside information." His power of observation is keen, and his habit of analysis and deduction is wonderfully developed. In the surging crowd around an active stock he sees things with microscopic eye, and acts with surprising promptness; once his conclusions

<sup>2</sup> Van Antwerp, p. 285.

are reached, speed and agility are relied upon to do the rest. Age cannot wither, nor custom stale, his infinite variety. He is a bull one minute, and a bear the next. He is intent, resourceful, suspicious, vigilant, and ubiquitous. He asks no quarter, and gives none. Now he is sphinx-like, deaf, inscrutable and impenetrable; now exploding with the frenzy of battle. You may stand and chat with him, and he may seem to listen to you. In reality he does not hear you at all. His roving eye is elsewhere, his mind is intent on other things. In the middle of a sentence he may leave you abruptly and go tearing from crowd to crowd like a thing possessed, the incarnation of energy.

From the nature of his business the floor trader does not usually need to maintain an elaborate office. Often, indeed, the floor trader simply hires desk room in some commission office. For the same reason he usually clears his transactions through some commission house instead of attempting to handle the work of clearance through an office and with employees of his own. In such an event his purchases and sales of stock are consequently entered on the clearance sheet of that commission broker, along with the latter's transactions.<sup>3</sup> Usually, therefore, in making contracts for the delivery or receipt of stock on the floor, the floor trader "gives up" the name of this clearing member rather than his own. In return for the responsibility and labor assumed by the clearing member, the floor trader pays him a clearance fee of \$1 or upwards per 100 shares of stock cleared.

**The Floor Trader's Economic Services.**—The floor trader regularly performs two important economic services. For one thing, his speculative purchases and sales are of great assistance in maintaining a continuous market. As we have seen, they fill gaps which would inevitably occur in a purely broker's market. The floor trader's operations consequently serve as one of the means of imparting instant negotiability to all the Exchange's listed securities.

In the second place, he is of an even greater significance in stabilizing prices. As a matter of fact, the floor trader's best

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<sup>3</sup> See Chapter XII, p. 328.

opportunity for a profit exists when prices are for the time being out of line with true values.<sup>4</sup> Since as a rule he quickly sells out purchased stock, and quickly covers his short sales, his transactions are self-nullifying so far as any permanent effects on security prices are concerned. Nevertheless, his swift purchases and sales tend temporarily to restrain rising and to cushion falling prices, and, since they are normally undertaken for only fractional profits, they help to create a close market. It is largely owing to the work of the floor trader that momentary inequalities in the market arising from the mechanical methods of executing the round-share orders of commission houses and odd-lot dealers are speedily smoothed out and eliminated. In the maintenance of a stock market whose prices are constantly sensitive to supply and demand without erratically responding to mechanical and temporary limitations and conditions, a quick dealer for small speculative profits like the floor trader provides a very useful service.

**Uninformed Prejudice Against the Floor Trader.**—The floor trader could not afford to do business at such slight profits in a less highly organized market than the Stock Exchange, since he could not then be certain of buying or selling at will. Hence, as a quick “in-and-out” dealer in securities, he is essentially a product of the modern continuous market which by a process of evolution has been established on the exchanges. The popular prejudice against him is basically due to the fact that public knowledge has not kept up with the recent swift development of organized markets. Because the floor trader’s operations differ from the operations of dealers in more primitive and sluggish types of market places, in features developed by the recently created organized markets, they are apt to be regarded as illegitimate gambling transactions. Critics of the floor trader, lacking usually anything but an uninformed prejudice concerning his indispensable work in the market, fall back upon the clearance system as proof of his villainy. It is of

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<sup>4</sup> Chapter V, p. 133.

course a fact that he often buys and sells the same day, and, in consequence, does not usually need to receive or deliver securities but employs the Stock Clearing Corporation<sup>5</sup> as his agent to look after these matters for him.

But in this respect, the Stock Clearing Corporation as agent merely performs this work for him in the same way and with the same splendid economy of time, labor, and capital as it does for the other classes of Stock Exchange members. The contracts he makes are precisely similar to the contracts made on the floor by any other member of the Exchange, and are settled and cleared in just the same way. Far from allowing him to escape responsibility for his contracts in any way, the Stock Clearing Corporation is in reality the main agent for their punctual and absolute enforcement.<sup>6</sup>

Hence, so long as the floor trader is, by virtue of having made a contract to buy, long of any stock, he is just as certainly assuming the risk of owning that stock as if he already held the certificate itself in his box. The legitimacy of the floor trader's transactions in consequence cannot be questioned nor through a misunderstanding of the clearance system termed "gambling," without questioning the legitimacy, not only of the whole system of clearing stocks and bank credit operated by the Stock Clearing Corporation, but of every bank clearing house in this or any other nation. A wider knowledge of clearance as it is employed in the vast credit, security, and commodity markets of today quickly dissipates any such unfounded charges against the floor trader.

**The Floor Trader's Profits.**—An adequate notion of the floor trader's business can be gained only after some reference to its dollar-and-cents side. When his operations are normal and most useful economically, he is trading at his own risk for a profit on each transaction of  $\frac{1}{8}$  of a point, which amounts to \$12.50 gross on 100 shares of \$100 par stock. It must be remembered that the floor trader's calling involves large risks and

<sup>5</sup> Chapter XII, p. 325.

<sup>6</sup> *Ibid.*, p. 344.



necessitates the constant taking of losses. There is no magic and infallible formula available to the floor trader as he stands about the posts on the Exchange floor and makes his trades. Years of experience and the highest degree of natural aptitude and ability in the business do not prevent him from incurring frequent losses. His aim must be, therefore, not so much to avoid losses absolutely—for this would be utterly impossible—as to overbalance his losses with his profits.

But even if he is successful in three out of four trades, his net profit is not \$25, or anything like it. To begin with, as we have seen, he usually is forced to pay some commission house \$1 or more on each 100 shares to clear his trades, or else assume the considerable overhead expense of becoming a clearing member himself and providing the office machinery required to perform his own clearance. In either case the clearing expense is just as great on an unprofitable as upon a profitable transaction. Thus, on account of this expense alone, his net profits on a successful trade can be only \$11.50, and his loss on an unsuccessful trade will be \$13.50.

**State and Federal Stamp Taxes.**—But this is not all. On every sale of 100 shares of stock of \$100 par value he must pay \$2 for the New York State tax stamp and \$2 for the Federal tax stamp. These tax levies in themselves seem small enough, for both amount to only  $1/25\%$  of the par value of the shares. But when the small profits for which the floor trader deals are remembered, the matter assumes a very different aspect. Moreover, he is taxed just as heavily on his losses as upon his profits. Counting in these taxes, when he makes  $1/8$  on a trade his cash profit is only \$7.50, while when he loses  $1/8$  on a trade his actual cash loss is \$17.50. In consequence, if three out of four of his trades are successful, he makes a net profit of only \$5. And to be 75% successful in this business, with its stern demands of swiftness and accuracy and with its constant risks, is, as any floor trader will testify, no slight achievement.

Thus, the imposition of these State and Federal taxes upon sales of stock has placed a crushing burden upon the dealer in stocks who operates for small profits, and has led to abnormal and undesirable changes in the market's structure and methods of operation. To begin with, the number of floor traders has been considerably reduced as compared with pre-war times, despite the enormous growth of the stock market meanwhile. Former floor traders have either sold their seats and retired from the Exchange entirely, or else have abandoned this particular work for some other more lucrative activity on the Exchange floor.

Moreover, the floor traders who still remain have been forced to trade more intermittently and for larger fractions than  $\frac{1}{8}$ . Many have tended to become "long-pull" speculators, and to take a position in the market, thus being warped by heavy taxation out of their true function and greatest economic usefulness. For, from the economic standpoint, it is the customer in the brokerage office who can most usefully engage in security trades involving considerable intervals of time. Furthermore, the present-day floor trader has to some extent been forced to confine his operations to low-priced stocks, upon which the stamp taxes are sometimes at reduced rates. When he does deal in high-priced stocks, he is likewise impelled to avoid any except those with considerably greater fluctuations between sales than  $\frac{1}{8}$ , in order to realize a higher fractional profit on each trade.

**Economic Effects of Stamp Taxes.**—As a result of this reduction and metamorphosis of the floor trader's normal activities, the whole stock market has to a considerable extent been rendered less stable than formerly. Deprived of the floor trader's close intermediary bids and offers, prices have been subject to wider fluctuations, and the execution at close prices of the commission broker's orders, in both round and odd lots, has become more difficult.

When the State tax of \$2 was first laid, no very perceptible difference was felt in the market. Of course, the floor trader's risks were increased and his profits lessened, but no particular economic harm was done. But when the tax was doubled by the addition of the Federal tax the differential was sufficient to be of considerable importance. The Stock Exchange authorities, however, did not at the time appear before any Committee of Congress to "protest." They considered the tax a war measure and felt that even though the stock market suffered by it they must patriotically do their share in bearing the burden of the war.

But the continuation of these taxes into peace times has proved distinctly harmful. For the imposition of a heavy tax on the sale of securities, which are really credit instruments, amounts to and results in placing a dangerous burden upon credit itself. The untoward results of the tax are not dramatic nor vivid; nevertheless the tax constitutes an unseen drag and brake upon all large-scale American commercial and industrial enterprises.<sup>7</sup> It remains to be seen whether the United States can really function as a creditor nation and at the same time levy excessive and burdensome taxes upon its security markets.

This whole question of the national advisability of over-taxing sales of stocks is intimately related, not simply to the livelihood of the various classes of security brokers and dealers in and out of the Stock Exchange, but to the security investor from whom the tax is really collected. The tax has been discussed in connection with the floor trader because its uneconomic and harmful effects have in his particular case been most clearly and directly manifested.

**The Specialist.**—Returning again to the subject of dealers in the Exchange, we must next consider the specialist, a most important factor both as a dealer and a broker in the market place of today. For, as we will shortly observe, the specialist may execute orders in stocks either for himself or as an agent

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<sup>7</sup> See Appendix VIIIB.

for other brokers. The name "specialist" is derived from the fact that he specializes in the execution of orders in stocks located at the same post on the floor. Sometimes, indeed, in an unusually active stock with a heavy turnover, he will confine his entire attention to dealing in the stock issue of a single corporation.

Tradition has it that the first specialist on the Exchange was a member who had been prevented from pursuing an active career in the commission business through breaking his leg. As a temporary experiment, therefore, he took his seat in the midst of the crowd trading in Western Union, then a very active stock, and executed orders only in it. Much to his own surprise, as well as to that of his associates, he soon found his new occupation more profitable than his former one, and even after his leg had mended, he continued in it. Other brokers followed his example and became specialists—a shift which the steadily growing volume of business on the Exchange favored—until today over 300 Exchange members can be found constantly stationed at the various posts, and constituting a vital and integral factor in the present-day stock market. Since there is probably no class of dealers or brokers within the membership of the Stock Exchange concerning which more misunderstanding exists, it is of importance that the methods and significance of the specialist be described at some length here.

**Clearance and Trading of the Specialist.**—Sometimes, as in the case of the floor trader, the specialist clears his own purchases and sales of stocks through some commission house. For such service he pays the same sort of fee as the floor trader does. On the other hand, the specialist sometimes not only performs his own clearance, but also clears for other members in return for a clearance fee. On orders of stock which he purchases or sells as a broker for other members, the specialist, as in the case of the two-dollar broker,<sup>8</sup> receives a commission from the broker for whom he executed the order.

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<sup>8</sup> See Chapter III, p. 83, and Appendix VIIIc.

The majority of specialists act as dealers in much the same way as the floor traders do, and speculate for small, quick profits. In this buying and selling of securities with other Exchange members for their own account, the specialists perform many of the functions of the "jobbers" in the London Stock Exchange. Far from there being any reasonable ground to object to this trading by the specialist, in reality the practice constitutes one of his most useful functions in the Exchange and renders the same general economic service that the more scattered transactions of the floor trader do. For, if the specialist refused to engage in speculative dealings on his own account, there often might not be sufficient orders for stocks, either in his book or with other members of the crowd, to make a close market for them. The Exchange insists, however, that when the specialist does trade for himself, he must not pretend to be executing orders as a broker.<sup>9</sup> The specialist is, therefore, forbidden in any transaction to charge a commission as a broker and at the same time make a profit as a dealer.

**Precedence of Customers' Orders.**—Furthermore, the specialist is compelled to give precedence to his customers' orders for the purchase or sale of securities, over the orders which originate with himself as a dealer, granting always that both his and his customers' orders are either market orders or else limited at the same price. If, for example, a specialist has a customer's order to buy 100 Reading at 75, and at the same time wishes to purchase the same amount of the same stock at the same price, he must execute the customer's order before buying his own stock. But if the specialist is willing to pay  $75\frac{1}{8}$  or  $75\frac{1}{4}$  for the 100 Reading, he can, of course, do so first. Similarly, if the customer's order is for the sale of 100 Union Pacific at 180, the specialist can sell 100 Union at  $179\frac{7}{8}$  or  $179\frac{3}{4}$  for himself, but cannot sell his own stock at 180 till he has executed his customer's order. With market orders the customer's order always has precedence.

<sup>9</sup> See Chapter III, p. 83, and Appendix VIII d.



This rule with regard to the execution of orders by the specialist is strictly enforced and violations of it, which might, of course, amount to "trading on his customers' orders," have long been severely punished. Indeed, attempted breaches of this regulation are usually easy to detect, both from the action of prices on the ticker tape and from the keen and experienced observation of other members about the post.

**Specialist as Broker.**—As in the case of the floor trader, the present tax upon sales of securities has proved very burdensome to the specialist as a dealer, and by artificially deterring him from entering into transactions for close profits, has extended a similar disruptive and weakening influence upon the machinery of the stock market. Nevertheless, unlike the less fortunate floor trader, the specialist has his brokerage business to fall back upon. Indeed, his principal business has always consisted in serving as a broker for other brokers in his few particular stocks.

Since he is always stationed at a single post, he is able to handle customers' orders which other brokers are unwilling or unable to execute. If the commission broker were forced himself to execute for his customers, stop orders or other orders limited to prices far from the current market price, he might be compelled to remain at the given post with a single order for an indefinite period of time, lest he should "miss his market." Such a course would be unprofitable and impossible. Consequently, such orders, as well as orders that are difficult of execution because of the inactivity or the intense activity of the stocks in question, the commission broker usually turns over to the appropriate specialist to watch and to execute, when the right moment arrives.

From the specialist's standpoint, therefore, he is entrusted as a rule only with those orders which no one else wants to try to execute. For, when the order first comes to the Exchange floor the commission broker gets it at his telephone; if unwilling to try to execute it he may turn it over to a two-dollar

broker, and not until the latter has abandoned it does the specialist get it. Thus, the specialist's business has its drawbacks, like everyone else's—otherwise everyone on the Exchange would want to be a specialist and nobody would be left to fill any other function.

**Odd-Lot Business of Specialist.**—Formerly, before the present extensive odd-lot houses<sup>10</sup> had evolved, the specialist used to execute in his few particular stocks fractional orders from 1 to 99 shares as a broker for the odd-lot dealers of that time. This commission business in odd-lots materially assisted the specialist during the earlier and financially leaner years of his existence, when the turnover in the market was small and his business was scanty. But with the growth of Exchange transactions and the increasing 100-share business undertaken by the specialist, his odd-lot business became less welcome and in the end suffered from unavoidable and natural discrimination. In consequence, as will be related in the next chapter, the present odd-lot houses naturally evolved.

Some few specialists, however, still execute orders for odd lots in the same way as the present-day odd-lot dealer. Although the aggregate bulk of odd-lot orders thus executed is not a large factor today, nevertheless, the specialist, among his other functions, is always a potential if not an actual competitor to the odd-lot dealer, and as such exerts a salutary even if a somewhat negative effect on the odd-lot business of the present time. This fact perhaps accounts for a common tendency on the part of the public to confuse the specialist with the odd-lot dealer.

**"Crossing" Orders.**—There is still another constitutional restriction<sup>11</sup> upon the specialist as a broker which deserves attention. Even more frequently than is the case with the commission broker, he will find on his book (of which more anon) orders to buy and to sell the same amount of the same stock at

<sup>10</sup> See Chapter IX, p. 234.

<sup>11</sup> See Chapter XV, p. 455, and Appendix VIIIe.

the same price. He might, for example, discover that he had 200 shares of Union Pacific to buy, and 200 shares to sell, at 190. Before he can "cross" these orders, as it is called, he must publicly offer the 200 to sell at  $\frac{1}{8}$  higher than the 200 to buy. Thus, if anyone in the crowd is willing to pay  $190\frac{1}{8}$  for the stock to be sold, its seller gets the advantage of the  $\frac{1}{8}$ . But if no one accepts the offer, he may then cross the orders without the possibility of doing the seller any injustice.

**Occasions for Specialist's Services.**—Before a clear notion of the specialist's work can be acquired, reference must be made to the actual methods by which it is conducted. If our friend Jenkins, the commission broker, is called to his telephone and given an order to buy 100 shares of Baltimore & Ohio Railroad at 115 when the stock is selling around 125, Jenkins knows it would be a waste of his time to take the order to the post where this stock is dealt in and attempt its execution. Accordingly, he instructs his phone clerk to dispatch the order to William Brown, the specialist in "B. & O.," through the pneumatic tube system which connects members' telephone booths with the stock posts.<sup>12</sup> When the specialist in B. & O. gets Jenkins' order for 100 shares at 115 from the tube attendant at his post, he inscribes the order in his book, and there it stays (unless it is canceled in the interim) until the stock declines sufficiently to permit of its execution at the limit of 115 set. The order to the specialist is sent on a slip shown in Figure 12a. Attached to this slip is a carbon copy (Figure 12b) which the specialist signs and returns to Jenkins' phone clerk by way of confirming the receipt of the order.

A somewhat different case might call for a slight departure from the above routine. If Jenkins receives an order to buy 100 American Sugar Refining at 100, at a time when it is selling at about 101, he will probably go to the Sugar post with it himself. He will not give the order to a specialist to execute if he can avoid it, since, if he does so, he must pay the specialist

<sup>12</sup> See Appendix IIIg.

\$2.50 out of the \$25 he receives from the customer for executing the order. After watching Sugar sell at 101, 100¾, 100⅞, and 100½, Jenkins sees his number appear on the annunciator board, and knows he is wanted at his phone. On the other hand, he does not dare take the order with him, while the stock is breaking toward par lest he miss his market. Hence, he gives the order to the specialist in American Sugar.

July 1<sup>st</sup> 1929

WEEK MONTH G. T. C. ✓

**BUY**

100 B. & O.

115

**JENKINS & CO.**

Booth XX

Figure 12a. Buy Slip for a "Give-Out" Order

Employed when one member instructs another member to execute an order in his behalf.

NEW YORK July 1<sup>st</sup> 1929

RECEIVED FROM JENKINS & CO.

ORDER GOOD FOR

WEEK MONTH G. T. C. ✓

**TO BUY**

100 B. & O.

115

PLEASE SIGN *William Brown*

Figure 12b. Carbon of Figure 12a

Showing confirmation signed by specialist, William Brown.

Even while he is at his phone getting another order, the specialist may have executed the order in Sugar. If so, the specialist makes out a report of the purchase<sup>13</sup> and sends it back to Jenkins' telephone clerk through the tube system.

**Method of Operating.**—Let us look for a moment at the physical condition surrounding the work of the specialist. All day long he stands beside a single post on the floor. Around him gather the crowds in the particular stocks in which he deals, composed of eager commission brokers, two-dollar brokers, busy odd-lot dealers, and swift floor traders. In a

<sup>13</sup> See Chapter VI, p. 166.

moment of activity, especially at the opening at 10 A.M., the crowd may number 40 or more. The specialist is receiving new orders and canceling old ones (Figure 13), quoting bids

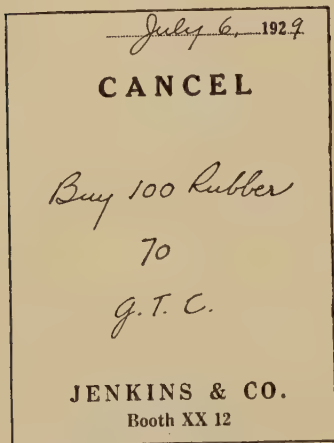


Figure 13. Cancel Slip  
Showing cancellation by Jenkins  
& Co. of its former order to buy 100  
shares of U. S. Rubber at 70.

and offers and effecting sales, making out binding reports, constantly revising the orders inscribed in his book, and perhaps attempting to deal on his own account, in competition with the lightning-like floor traders. The specialist must not only watch the market, and everyone in the crowd likely to do business in it, but he must also, as a broker, represent both buyers and sellers at once, and favor neither unduly. Meanwhile, since he is often the core of the market himself, everyone is watching him intently, ready to cry "Sold"

to his bids or "Take them" to his offers. As a prominent specialist<sup>14</sup> once stated:

You must remember that the specialist is not over in a closet or up on a pillar where nobody can see what he is doing, but is standing down on the floor; and in an active market, 20, 30, or 40 men see him; they see him get the orders and see him execute these orders, so that there is almost, you might say, a check-up on him, every single minute.

"Stopping Stock."—The practice of "stopping stock," which is employed by brokers on the floor, should also be mentioned in especial connection with the specialist, since the responsibility for the occasional misunderstandings to which it gives rise are so often placed at his door.<sup>15</sup> This class of orders must not be confused with stop-loss orders.

<sup>14</sup> Address of Erastus T. Tefft before the Convention of Out-of-Town Stock Exchange Members, April 15, 1921.

<sup>15</sup> See Appendix VIII f.



A broker with 100 shares of U. S. Rubber to sell may make a private agreement with the specialist or some other broker, to "stop" them with him—that is, to sell them to him either at the price of the next sale, or at a subsequent sale at a stated price. The principal purpose in "stopping stock," as it is called, is, of course, to insure both parties against the danger of missing a market, and the practice tends to stabilize the market and to reduce the number of separate fractional fluctuations. Since such an agreement is essentially a private transaction, although based upon the public market, a sale of stopped stock is not reported on the stock ticker, although, of course, the simultaneous sale in the open market upon which it depends is printed there. If, for instance, A as a seller stops 200 U. S. Rubber with B at 75, and if B later purchases 100 U. S. Rubber from C in the open market at 75, the quotation on the tape states the price at which both sales were made, but only the amount of stock publicly sold—or in this instance, the 100 U. S. Rubber which B bought from C. Incidentally, this fact is often overlooked by statisticians in computing total sales of stock on the Stock Exchange.<sup>16</sup>

Stock which is stopped at the opening must be offered without reference to any definite price, for the Constitution of the Exchange<sup>17</sup> forbids the making of any bid, offer, or transaction before 10 A.M. or after 3 P.M. (Saturdays, after 12 M.). On a wide opening such agreements to stop stock are made "fair opening"—that is, at a fair mean between the high and low opening prices. If a stock simultaneously opened at 60 and 61, a fair opening would usually be  $60\frac{1}{2}$ .

**Congestion in the Specialist's Business.**—The specialist is often subject to great pressure of business when intense activity develops in the particular stocks in which he specializes. Sometimes he is much overworked at the opening of the market, which is apt to be the most congested and difficult period

<sup>16</sup> See Appendix VIIIg.

<sup>17</sup> See Chapter III, p. 80, and Constitution of the Stock Exchange, Rules, Chapter I.

in the Stock Exchange day. In addition to his sufficiently extensive tasks already alluded to, he must watch everyone in the "crowd" about his post, lest someone sell stock below the limit at which he must buy it, or above the limit at which he has to sell it; he must also see what the "fair opening" is, and whether a "split opening" is printed correctly on the stock tape; and he must constantly make changes in the orders which he is handling as new orders and messages pour in upon him. Sometimes a single order will be changed half a dozen times in ten minutes. He must also make out written and binding reports on every transaction he has made as an agent for another member; every such report must be checked before it goes out, lest—say— $\frac{3}{8}$  instead of  $\frac{3}{4}$  be erroneously written in haste, and thus make enemies for the specialist or perhaps impose losses upon him.

Formerly, due largely to the inflexible prohibition against non-members on the Stock Exchange floor, the specialist himself was forced to do not only all his buying and selling, but also the considerable amount of detailed clerical work above described. Sometimes the volume of this work was such that it was humanly impossible for one person, however nimble or experienced, to perform it speedily and well. Even when the specialist pressed his telephone clerk into service to make out reports, it failed to solve the problem. The Stock Exchange authorities discussed this occasional overcongestion of the specialist's business for years without arriving at any practical solution for it.

The increased stock market activity of 1928-29, however, clearly indicated that some remedy must be found, and that promptly. Accordingly, the Committee of Arrangements adapted the new "stock post" which it had devised, to the particular needs of overworked specialists. As an exception to the Stock Exchange rule, specialists were permitted to have their own clerical employees assist them in their work on the floor. Such specialists' clerks are not, however, technically

permitted on the trading floor itself, since they must always remain inside the new hollow stock posts; they, of course, are never permitted to buy or sell securities, or to exercise any of the prerogatives of Stock Exchange membership. The specialist's clerk simply assists his employer with the mechanical and clerical side of the work. The clerk, for example, sorts out incoming orders for the specialist to execute, arranging buying orders by  $\frac{1}{8}$ s below, and selling orders by  $\frac{1}{8}$ s above, the current price. Market orders and also orders limited at prices close to the current price are turned over at once to the specialist himself. The clerk, however, can keep a loose-leaf book in which buying orders limited at prices considerably below the market, and selling orders limited at prices considerably above the market, can be systematically inscribed. When the specialist has made a purchase or sale as agent for another member, from his memorandum of sale his clerk inside the post can speedily make out a binding report of the transaction, check it, and dispatch it to the giver of the order.

Sometimes, in an unusual rush of business, both the specialist and his clerk or clerks may have all they can do to keep up with the work. For such emergencies, the Stock Exchange now provides a special force of its own floor employees solely to assist the specialists; these Stock Exchange employees move about from post to post, wherever trading activity is most intense, and relieve pressure on the specialist and his clerk or clerks by sorting out the orders which come to him. The specialist's clerk sometimes has a direct private telephone connection with the specialist's office, which enables misunderstandings or confusion in regard to his work to be quickly rectified. The Stock Exchange employees who assist specialists, like other Exchange floor employees, are always in uniform with "Specialist" marked on their sleeves; the specialists' own clerks within the stock posts are in ordinary civilian attire.

Undoubtedly these new facilities thus placed at the elbow of the specialist to facilitate his work have greatly increased

the speed and efficiency with which his work is handled; on the other hand, they are not necessarily a panacea for all the problems of his business, especially in active markets, and they have considerably increased the number of persons on the congested Stock Exchange floor.<sup>18</sup>

**Specialist's Book.**—Orders limited at prices considerably above or below the current market price are, as already stated, usually kept by the specialist's clerk in a loose-leaf notebook. But market orders, and also orders limited at prices reasonably close to the market, are handled by the specialist himself.

Most specialists keep a record of such limited orders close to the market in a pocket notebook, usually about 8 inches long and  $3\frac{1}{2}$  inches wide. Since this specialist's book is merely a personal memorandum book, its exact character and the precise way in which entries are made in it depend mainly on the particular wishes of its owner. Practice in this regard is, however, sufficiently similar to permit the description of a typical specialist's book in the ensuing pages.

At the top in the middle of the page is inscribed a round figure close to the market price of the given stock issue. In the illustration (see Figure 14) this is 95. All the specialist's orders limited at that price are written in below it, buy orders on one side and sell orders on the other. At appropriate distances down the middle, directly beneath the "95" are increasingly higher fractions by  $\frac{1}{8}$ s up; here orders limited at these fractions are similarly inscribed. The range of prices on a page depends upon the number of orders to be entered beside them, which in turn depends upon the relative activity or inactivity of the stock in question. The way in which an order is usually entered in the specialist's book also requires explanation. First, the number of shares involved is recorded in terms of hundreds (i.e., 1=100, 2=200, etc.); next is inscribed the name of the firm or individual who has given the order to the specialist, and after this name the period during which the

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<sup>18</sup> See Appendix VIIIh.

| BUY        |            | 95            | SELL          |
|------------|------------|---------------|---------------|
| E. West    | 3 Stop m.  | 2 H. T. C.    | H. Lewis      |
| Lee & Co.  | 1 Stop m.  | 5 H. T. C.    | F. Park       |
|            |            | 10 m.         | Fisk & Co.    |
|            |            | 7 m.          | Stan & Co.    |
|            |            | 1 m.          | C. Brin       |
|            |            | 2 m.          | May Bros.     |
|            |            | 4 m.          | F. Dean & Co. |
|            |            |               |               |
|            |            | $\frac{1}{8}$ |               |
|            |            | 2 m.          | F. Hill       |
|            |            |               |               |
|            |            | $\frac{1}{4}$ |               |
| R. Lamb    | 1 Stop wk. | 2 m.          | F. Mason      |
|            |            | 1 wk.         | B. Allen      |
|            |            | 1             | Rolls Co.     |
|            |            | $\frac{3}{8}$ |               |
|            |            |               |               |
|            |            | $\frac{1}{2}$ |               |
| E. Ross    | 2 Stop m.  | 5 m.          | M. Craig      |
|            |            | 4 wk.         | L. Wilcox     |
|            |            | 1 wk.         | Munroe & Co.  |
|            |            | 1 wk.         | R. Gibbs      |
|            |            | $\frac{5}{8}$ |               |
| Long & Co. | 2 Stop m.  |               |               |
|            |            |               |               |
|            |            | $\frac{3}{4}$ |               |
| E. Parlos  | 2 Stop m.  | 1 m.          | E. Store      |
|            |            | 1 m.          | R. Lard       |
|            |            | 2 m.          | Butt & Co.    |
|            |            | 1 wk.         | W. Austin     |
|            |            |               |               |
|            |            |               |               |
|            |            |               |               |
|            |            |               |               |

Figure 14. Specimen Page of a Specialist's Book



order is effective. "G.T.C." indicates orders "good until countermanded"; "M.," "orders for the month"; "Wk.," "orders for the week"; if no sign at all is added, an order good for the day only is indicated. Stop orders are denoted by "Stop." It will be recalled that stop orders are not limited at the price set, but simply become market orders when that price is reached.<sup>19</sup> In addition to his book, market orders are handed to the specialist on slips made out by the brokers' telephone clerks, and are not inscribed in his book but handled separately. The specialist's book is, of course, not shown by him to others, except in case he is compelled to leave the floor, when he temporarily entrusts it to some one person—either another specialist at the same post or some other member.

The specialist, with his book and his market orders, is a factor of constantly varying importance in the market for each stock. Sometimes, especially in the more inactive stocks, he may have almost all the orders for a given stock, and will consequently make the market for it. But, of course, anyone at any time can take the market away from the specialist by quoting closer prices. Furthermore, there are sometimes several different specialists in a given stock, competing with each other. Moreover, the floor trader will, under normal circumstances, compete with him to render prices closer, if there is a prospective profit of only  $\frac{1}{8}\%$  to be gained thereby. On the other hand, a majority of orders in the stock may drift into the hands of brokers in the crowd—in which case the specialist ceases to be a dominant factor in the market for the stock.

**Before the Opening of the Market.**—We are now prepared to follow with readier comprehension a detailed and typical cross-section of the specialist's daily work.<sup>20</sup> For this purpose an active opening had best be selected, since this point in the day creates the most serious problems and misunderstandings. In order that the opening may be sufficiently active,

<sup>19</sup> See Chapter VI, p. 159.

<sup>20</sup> For the subsequent practical examples of the specialist's work, the author acknowledges his indebtedness to the address of Mr. Erastus T. Tefft previously cited.

let us suppose that the stock selected closed the previous day at 93, and that overnight announcement has been made that its dividend would be increased.

Knowing in advance that the opening will be active, the specialist arrives at his post that morning at 9:30, and begins to enter in his book the orders which are given him. The tubes and the boys on the floor handle many thousands of separate slips of paper between 9:30 and 9:45 A.M. Every one has to be opened and examined, and if the man who reads them makes any mistake, he is, of course, held responsible for it. In this connection it may be said that out-of-town branches can greatly assist the specialist by not sending in, just before the opening, orders with limits 30 points away from the market, as the congestion at this time is at its height.

The specialist finds at 9:59 (see Figure 14) that, counting both his old orders and those received that morning, he has stop orders at 95 to buy 300 shares for West and 100 for Lee; at  $95\frac{1}{4}$ , 100 for Lamb; at  $95\frac{1}{2}$ , 200 for Ross; at  $95\frac{5}{8}$ , 200 for Long; and at  $95\frac{3}{4}$ , 200 for Parlos. On the other hand, he has to sell at 95, 200 for Lewis, 500 for Park, 1,000 for Fisk, 700 for Starr, 100 for Lorin, 200 for May, and 400 for Dean. In addition, there are the selling orders at  $95\frac{1}{8}$ ,  $95\frac{1}{4}$ , etc., which are indicated in the illustration.

Before 10 A.M. the crowd begins to gather about the post, ready to execute orders in this stock as soon as the gong sounds. On a day like this there are naturally many more buying than selling orders, since the dividend has been increased. Consequently, it is easier for sellers to find buyers than for buyers to find sellers. Each seller who comes into the crowd says, "I will sell a hundred." At once he is pounced upon by a buyer and he stops his stock with him at a fair opening. That is, the seller agrees to sell his stock to the buyer at a fair opening price; for reasons already given, no price can be named before 10:00 A.M. Such an arrangement is, of course, beneficial to both buyer and seller, and insures both against executing their

orders at a price other than the actual opening price, which it is doubtful if they could otherwise exactly secure. But this process of stopping stock leaves many buyers in excess, who, lest they miss their market, hand their orders at about 9:57 A.M. to the specialist to execute for them. At 9:59, therefore, the specialist discovers that these order slips which have been handed to him will force him to buy 2,200 shares at the market on the opening. On the other hand, he has 3,100 shares to sell at 95. Meanwhile, about thirty brokers and traders have gathered in the crowd around him. With all these orders both to buy and to sell, he must, of course, make both bids and offers for the stock on the opening. He cannot guess exactly at what price the first sale will be made, but tries to approximate it as nearly as he can on the basis of the orders he has received.

**Trading at the Opening.**—Hardly has the gong sounded at just 10 A.M. when the specialist cries "1,000 at 95,  $94\frac{3}{4}$  for a thousand," meaning that he will sell 1,000 shares at the former price, and buy 1,000 at the latter. Simultaneously, some other broker bids " $95\frac{1}{4}$  for 500" and another cries "Sold"; another man offers "500 at  $94\frac{3}{4}$ " and someone else says "Take them"; while (as the specialist learns a moment later) another pair on the edge of the crowd make a sale of 200 shares at the higher figure of  $95\frac{3}{4}$ . All three transactions happen at the same instant. A fraction of a second later the specialist cries " $\frac{7}{8}$  for thousand, a thousand at 5—take a thousand at 5—2!" These cryptic and tremendously abbreviated words mean that the specialist bids for 1,000 shares at  $94\frac{7}{8}$ , and offers 1,000 at 95, and then buys first 1,000 shares from his selling customers for his buying customers at 95, and then another 1,000 shares.

The next problem is to determine what the opening price was. As we have seen, it has really been a "split opening," for 500 shares have been sold at  $94\frac{3}{4}$ , 2,000 shares at 95, 500 shares at  $95\frac{1}{4}$ , and 200 at  $95\frac{3}{4}$ . The last-mentioned sale has not been skilfully made, and, considering the few shares sold

at this price, it would not be fair to quote the split opening  $94\frac{3}{4}$ – $95\frac{3}{4}$ . Thus the opening is printed on the tape as 3,000 shares from  $94\frac{3}{4}$  to  $95\frac{1}{4}$ . But the 200-share sale cannot simply be disregarded, so "200 sold  $95\frac{3}{4}$ " is also put on the tape. Meanwhile, orders which were stopped have been executed at 95 as a fair opening price, but these, as previously explained, are not put on the tape.

Returning to the specialist, we find that, in addition to the 2,000 shares, he has crossed 200 more, and has sold 500 besides in the open market. Thus far, after doing everything humanly possible, he has executed all his market orders, and 2,700 out of his 3,100 original selling orders, leaving him 400 more to sell at 95. Meanwhile the ticker reports the opening price as "3,000 at  $94\frac{3}{4}$  to  $95\frac{1}{4}$ ," and every customer who has placed an order within those limits at once concludes that his stock has been sold. The specialist may yet sell out his 400 at 95, his 200 at  $95\frac{1}{8}$ , and his 400 at  $95\frac{1}{4}$ , if the market moves in just the right way. But if it grows somewhat dull and prices do not rise again above 95, all the  $\frac{1}{8}$  and  $\frac{1}{4}$  stock customers, whose orders, of course, cannot be executed under these circumstances, are going to blame the specialist for not being able to sell their stock, and quote the split opening of  $94\frac{3}{4}$ – $95\frac{1}{4}$  as conclusive proof that they have been done an injustice. Split openings also sometimes create a suspicion that somehow the specialist has bought at the lesser and sold at the greater price on his own account. Indeed, years ago, one specialist in an opening of 61– $61\frac{3}{4}$  did attempt to buy for himself all the stock he had to sell at 61, and to sell for himself all the stock he had to buy at  $61\frac{3}{4}$ . He lasted just four days.

**Execution of Stop-Loss Orders.**—Another source of difficulty and misunderstanding arises from the execution of "stop-loss orders." As has been explained, a stop order becomes a market order when its limit price is reached. It sometimes happens that as stock prices decline on the Exchange, a figure will be reached at which several stop orders will suddenly





70 to 65 is here the source of the inevitably violent price fluctuation. We will also presuppose that a severe decline has taken place in this stock the day before and that overnight the dividend has been reduced 1%. At the close the day before, 70 was bid for 200 shares, and 100 were offered at 73.

At 9:55 the next morning the specialist finds that in addition to the orders in his book, as shown in Figure 15, he has five 100-share lots to sell at the market. And now comes the crucial question—at what price will the market open? No matter what price between 69 and 65 this stock sells at, the specialist's shares to sell at the market will be increased by the many stop orders to sell. Under such circumstances stock to be sold is bound greatly to overbalance stock to be bought, and hence a severe decline is unavoidable. In this instance the specialist happens to have the market all to himself, and opens the stock "1,600 shares sold at 64." By so doing all selling and buying orders, except the 100 to sell at 73, are executed at this single price. The disadvantage of this method of opening the stock is, of course, that the 500 shares to sell at the market are sold at a very low price. But it must be remembered that the specialist as an agent and broker stands in the same relationship to his buying customers as to his selling customers. In the light of the obvious conditions of supply and demand in this stock, prices are bound to decline. What is fair to pay for the seller's stock when the specialist knows these conditions? Why should he pay more for that stock than the price at which all the orders can be crossed? So it is undoubtedly better that the stock should open 1,600 shares at 64. Since this is the first and only sale, customers could not declare that they had been discriminated against and would probably be inclined to take such an occurrence as the fortunes of war.

**Advantage of This System of Opening.**—The advantage and fairness of opening the stock in this way becomes more apparent when some other way is attempted. Let us suppose that in the above instance the specialist proceeded as follows:

He opens the stock, 400 shares at  $68\frac{1}{2}$ , by selling 200 shares of his stock to be sold at the market to Macy, 100 shares more of it to Wells, and still another 100 of it to Cooper. In addition to the remaining 100 shares to sell at the market, he now has 400 additional market orders to sell, owing to the fact that the first sale at  $68\frac{1}{2}$  made active the stop orders of Doe for 100, Nash for 100, and Roe for 200. He next sells his last 100 shares of original market stock to Dunn at 68, thereby increasing his market selling orders to 800 shares by making active Smith's stop order at 68 to sell 400 shares. All his original market orders to sell have, however, now been executed. He next sells Doe's 100 and Nash's 100 to Doe at 67, and then 200 of Smith's stock to Ray at 66. But this latter sale "touches off" King's 200-share stop order at 66, and thus the specialist still has 600 shares to sell at the market. The third 100 of Smith's stock is next sold to Field at 65, thereby making Platt's 100-share stop order at that price a market order. The specialist still has 600 shares to sell at the market, namely, Smith's last 100 shares, Roe's 200, King's 200, and Platt's 100. These are all sold to Cole at 64, thus cleaning up all the orders on the book except West's 100 to sell at 73, which cannot under the circumstances be executed at all. Soon the tape gives the report of these transactions: 400 at  $68\frac{1}{2}$ . . . . 100 at 68. . . . 200 at 67. . . . 200 at 66. . . . 100 at 65. . . . 600 at 64. The last sale, of course, includes 100, 200, 200, and 100 shares to sell.

But what does Doe, with the stop order at 70, say when he is told that his stock brought only 67, after seeing 400 sell at  $68\frac{1}{2}$  and 100 at 68? What does Roe say when he learns that his 200 shares went for only 64? Neither is Smith pleased to receive the reports from his 400-share stop order at 68, which show sales at 66, 65, and 64. Such executions could not be explained, and apart from the endless quarrels and dissatisfaction they would cause to sellers, the buyers would meanwhile be treated unfairly. The fairest way to both buyers and sellers is, therefore, to open the stock 1,600 shares at 64. And this is

one of the chief reasons why in such inactive stocks occasional bad breaks in price of this kind occur.

**“Touching Off Stop-Loss Orders.”**—Sometimes complaint is made to the Stock Exchange, that traders there make it a practice to “gun for stop orders.” In other words, if a trader knew that by selling a few shares short he could sufficiently exhaust the demand for it at higher prices, and cause its price to decline to a point where several stop-loss orders would automatically be converted into market selling orders and cause a further price decline, he could cover his short sale at the lower price thus reached and thus obtain a profit for himself. In point of fact, this sequence of events occurs now and then, but more by accident than by design. For it must be remembered that the short seller cannot possibly know all the factors of supply and demand existing in the market. Such an attempt might involve sales of a large number of shares, and the consequent danger of heavy losses. Moreover, the depression of a price by such selling might equally well uncover large buying orders, which would either halt the decline, or in certain circumstances (as with stop orders to buy) drive prices back to higher levels.

Of course, if the specialist attempted to take advantage of his knowledge of his orders, he would by no means be certain of success, since, as we have seen, the dominant influence of supply and demand may really exist at a given time in the crowd rather than in his book. Moreover, such an attempt by the specialist would be practically certain of detection by the crowd, and, owing to the concentration of orders in his hands, he would be certain of conviction. The price of such an attempt on his part would be expulsion from the Exchange, permanent disgrace, and the end of his career as a security dealer.

Violent declines due to stop orders being accidentally “touched off” will always occur now and then in the Stock Exchange. An example of much the same thing has, indeed, been given above. The newspaper man, bending over his type-

writer and hurrying his daily column of market news to press, may continue to find in this alleged "gunning for stops" a spirited human-interest motif with which to enliven the inevitably bleak mathematics of his items. The customer whose market order to sell has been executed for a lower price than he could wish, may accept this, as other Wall Street legends, with conviction. But the practical broker, trader, or specialist on the floor will tell a very different story concerning it.

**Specialist's Economic Services.**—A concluding paragraph is called for, to relate the more obvious economic services rendered by the specialist to the stock market on the Exchange. In so far as he acts as a dealer his function resembles that of the floor trader, in that he greatly assists in maintaining at his own risk a continuous market in securities. Hence, like the floor trader, he is a necessary instrument in the task of rendering securities listed on the Exchange instantly negotiable. Also, because of the close prices at which his own trades are carried out, the specialist performs a similar service in stabilizing price movements.

But apart from these considerations, the slow and natural evolution of the specialist as a broker's broker has been due to the mechanical impossibility of executing difficult brokerage orders in any other way. Without his services, therefore, the prompt acceptance and execution of many orders of vital moment to customers all over the country would be impossible. As we have seen, the stop-loss orders whereby purchasers of stock are enabled to avoid or at least minimize losses, could not be handled except for the specialist. In the universal process of specialization through which all modern business is passing, the specialist, as indeed his very name would imply, has been created by natural economic and practical causes to support weak markets, restrain soaring markets, stabilize prices, and in addition to prove at all times an indispensable medium through which a vast number of the buying and selling orders of the nation flow.

## CHAPTER IX

### THE ODD-LOT BUSINESS

**Odd-Lot vs. Round Lot.**—Thus far in the present volume, the description of transactions in stocks occurring on the New York Stock Exchange has invariably presupposed a purchase or sale of 100 shares, or some multiple of 100 shares. The reader, however, must not conclude on this account that no smaller number of shares than 100 can be bought or sold on the Exchange. As a matter of fact, a customer can through the agency of the ordinary Stock Exchange commission house buy or sell any number of shares from 1 to 99 with perfect readiness. But in the case of such orders for "odd-lots" of stock (as orders involving less than 100 shares are called), resort must be had to special methods which are unnecessary with orders for "round lots" or "full lots" of 100 shares, or multiples thereof, and which in consequence were not touched upon in the typical investment transaction described in Chapter VI. So considerable is the proportionate volume of these odd-lot orders today that the matter of their handling on the Stock Exchange deserves a separate chapter.

**Basis for the 100-Share Unit of Trading.**—First of all, a word is necessary concerning this 100-share unit of trading which prevails in the Exchange. Under ideal conditions the unit number of shares in which trading normally takes place would be the single share of stock. But the New York Stock Exchange is the principal security market in the United States—now the wealthiest nation in the world—and because of the vast extent and enormous cash value of the transactions which occur under its auspices it was long ago compelled to adopt wholesale as distinguished from retail methods of operation in



order to carry on its work efficiently and successfully. One instance of this fact has been the fixing of 100 shares of stock as the unit for ordinary trading on its floor.

**Difficulties with Smaller Trading Unit.**—Many practical considerations have combined to establish this 100-share unit as a necessity today. The number of odd-lot transactions occurring upon the Exchange each day is usually as great or greater than the number of round lot transactions. The flood of separate transactions which would result from the adoption of a smaller unit of trading would make it both impracticable and unprofitable for the commission broker or the specialist to give that conscientious attention to each individual order which is now a vital factor in establishing prices fairest to both buyers and sellers. A smaller trading unit would furthermore exaggerate the difficulty of making large purchases or sales of stock almost past the possibility of satisfactory performance. A broker, for example, with an order to purchase 10,000 shares—a delicate and laborious task even with the present 100-share unit—would find it practically impossible to execute it quickly and efficiently were he forced to accumulate it by 10-share or even 25-share purchases.

Other obstacles would also arise from trading in such a small unit. The banker loaning funds on security collateral would be forced to receive huge bundles of certificates which would be hard to safeguard and inspect. Moreover, the full burden of the greatly increased number of separate transactions in less than 100 shares would at once descend upon the indispensable stock ticker and largely destroy its usefulness; the tape would be clogged and delayed with the records of thousands of small and relatively unimportant transactions.<sup>1</sup> So often would its quotations be based on a negligible number of shares that a recorded price would lose the significance possessed by present prices, which represent transactions in 100 shares. This would be particularly true of closing bid and

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<sup>1</sup> See Appendix VIII f.

offer quotations with—say—a 10-share unit of trading; it would, for example, be very misleading to quote a final bid and offer for a stock as 99-99½, when 1,000 shares were being offered at ½ and only—say—20 shares bid for at 99. The adoption of the 100-share trading unit on the New York Stock Exchange today is in consequence not simply a matter of theoretical preference, but a practical and unavoidable necessity.

Yet at a market value of \$100 per share, \$10,000 would be needed to purchase 100 shares of stock outright, or \$2,500 at least for their purchase on credit. It is apparent that the present 100-share trading unit, were it not supplemented by other arrangements suited to the needs and requirements of the small investor, would deprive him of many facilities and services which the Stock Exchange daily renders the larger investor.

**The Odd-Lot System.**—Accordingly, a system having for its purpose the making of a market in less than 100-share lots of stock for the wide investing public whose purchases and sales occur in such amounts, has grown up in the Exchange. Certain of its members known as “odd-lot dealers” purchase odd lots of stock and later sell them out in 100-share lots, or sell odd lots which they obtain by purchasing 100-share lots and splitting them up into the smaller desired denominations. Sometimes, instead of buying 100 shares it proves more desirable to borrow that amount in the manner previously described in the instance of short sales;<sup>2</sup> but this practice amounts to about the same thing. Any member of the Stock Exchange is, of course, entirely at liberty to take up this work of dealing in odd lots, as well as any other particular sort of business transacted on the floor. But in practice, although a few specialists still do an odd-lot business in the particular stocks at their posts, the odd-lot business is today carried on almost entirely by what are known as the “odd-lot houses.”

**Evolution of the Odd-Lot House.**—These odd-lot houses have developed over the past half-century. When in the Civil

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<sup>2</sup> See Chapter VII, p. 187.

War period a continuous market was established on the Exchange it had already adopted the 100-share unit, and a single dealer on the floor named Munroe was able to attend to all the odd-lot orders received. After the panic of 1873 other Exchange members took up this branch of the work, which gradually increased in volume as time went on. After the appearance of the specialist<sup>3</sup> as a dealer and broker in the growing stock market, it came to be the custom for the few odd-lot dealers to have the specialist trade for them on commission. But with the further passage of time and the continued increase in the turnover of sales on the Exchange, the specialist's increasing work in 100-share lots prevented his handling these odd-lot orders with sufficient attention and care. The growing difficulty of finding a market for odd-lots of stock which resulted was thus the immediate cause for the organization of the present odd-lot houses, which depend entirely on their own floor representatives in making their sales or purchases.

**Nature of the Odd-Lot Business.**—In consequence, the odd-lot dealers today stand always ready to deal in any number of shares from 1 to 99 and thus make it possible for the small investor to purchase or sell odd-lots of listed stocks at all times. Their only customers are the commission brokers who, as middlemen, bring to them the orders for small lots which originate from small investors and traders all over the country. The odd-lot houses, as we shall presently see, not only maintain extensive offices and large clerical forces, but also must possess many partners or representatives who are Stock Exchange members. Certain odd-lot houses require the services of forty or more members of the Exchange, and have one or more partners or representatives stationed at each of the stock posts on the floor.

The odd-lot dealer is able to perform his useful function by purchasing shares wholesale in 100-share lots in the open market, and then splitting up the 100-share certificates into

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<sup>3</sup> See Chapter VIII, p. 210.

certificates of lesser denomination and selling them to commission brokers to fill such odd-lot buying orders as may have come into the market through the latter from the general public. On the other hand, the odd-lot dealer stands equally ready to purchase at any time such odd-lots of stock as may be offered by the public through their brokers. When the dealer's odd-lot purchases have aggregated 100 shares, he can readily resell them as a round lot in the open market. Thus the odd-lot dealers act as jobbers for the execution of buying and selling orders involving less than 100 shares which commission brokers receive from the public. Owing to the extensive equipment and efficient operation of the odd-lot houses, these small orders, whether for a purchase or a sale, can be placed by a customer in a commission broker's office, and then be executed almost instantly on the Exchange floor.

**A Typical Odd-Lot Transaction.**—Perhaps the best method of explaining the exact nature and methods of the odd-lot business is to describe a typical transaction from beginning to end. When a customer gives his order for the purchase of 20 shares of Sun Oil common stock to his commission broker, the latter at once transmits it to his telephone clerk on the floor of the Exchange. Some commission houses, either because of the large volume of their total transactions, or because of a tendency to specialize in just this odd-lot brokerage business, maintain on the Exchange a separate telephone booth for their odd-lot orders. With other commission firms, the order will be sent by the same telephone over which orders for 100 shares are transmitted. In either case, the odd-lot order is speeded from the commission office to the board room by precisely the same methods described in Chapter VI in the instance of a 100-share order.

**Transmission of Odd-Lot Orders.**—The telephone clerk might, of course, signal for the floor member of his firm on the annunciator boards, and turn the order over to him to execute

at the "Sun Oil" post, as in the case of a round lot order. But as a more satisfactory method in the case of odd-lot orders, the telephone clerk will probably turn such orders over to some one of the several odd-lot firms direct. He therefore writes out the order on an order blank, seeing that there is a notation upon it of the name of the odd-lot house in question, and hands it to one of the tube attendants stationed nearby. The attendant at once places it in a small cylindrical container and slips it into the appropriate hole in the nearest pneumatic tube station.

These tube stations are located on the Exchange floor at the end of the stalls containing the members' telephones, and each contains outlets of the pneumatic tubes running to the various stock posts.<sup>4</sup> The containers with odd-lot orders shoot through these tubes and emerge at the various receiving stations of the tube system at the stock posts. Thus the order for the "20 Sun Oil" very quickly arrives at the particular post where that stock is traded in. A tube attendant there at once takes the order from its container and places it on a rack reserved for the odd-lot dealer. A floor attendant is specially designated to see that such orders reach the odd-lot dealer promptly, so that the latter can handle them as quickly as possible. If it is an order limited at a price far away from the market of that moment, he may have to enter it in his book and sell the customer the 20 Sun Oil desired as soon as market prices will permit.

During the active business of 1928-29, facilities for sorting odd-lot orders for the opening were provided in a side room off the Exchange floor. In the fall of 1929, this system was utilized for odd-lot orders after the opening also. It partook of an emergency measure, and the extent of its employment has depended upon the general activity of the stock market.

As soon as possible after the sale or purchase of an odd-lot has been made, the odd-lot dealer makes out a report slip (Figures 16 and 17) which records the price at which the

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<sup>4</sup> See Appendix IIIg.



transaction was made, and sends it back via the tubes to the telephone clerk from whom the order came. The phone clerk in turn reports it to the commission office.

**Methods of the Odd-Lot Dealer.**—Let us now consider the transaction a moment from the viewpoint of the odd-lot dealer. He stands at a given post all day, prepared to buy or

|                                  |                                                                             |
|----------------------------------|-----------------------------------------------------------------------------|
| S                                | VKK<br>GHR<br>EPU<br>SUN<br>RBC<br>RY<br>WBP<br>GSW<br>CFM PR<br>PXC        |
| SOLD to <i>Jenkins &amp; Co.</i> |                                                                             |
| No. _____                        |                                                                             |
| SMITH & BROWN                    | VKK<br>GHR<br>EPU<br>20 SUN 71½<br>RBC<br>RY<br>WBP<br>GSW<br>CFM PR<br>PXC |
| S. O. FLAT.                      |                                                                             |

Figure 16. Odd-Lot Dealer's Sale Report Slip

Recording sale by the odd-lot house of Smith & Brown to the commission house of Jenkins & Co., of 20 shares of Sun Oil at 71½.

|                                      |                                                                             |
|--------------------------------------|-----------------------------------------------------------------------------|
| S                                    | VKK<br>GHR<br>EPU<br>SUN<br>RBC<br>RY<br>WBP<br>GSW<br>CFM PR<br>PXC        |
| BOUGHT FROM <i>Jenkins &amp; Co.</i> |                                                                             |
| No. _____                            |                                                                             |
| SMITH & BROWN                        | VKK<br>GHR<br>25 EPU 49¼<br>SUN<br>RBC<br>RY<br>WBP<br>GSW<br>CFM PR<br>PXC |
| S. O. FLAT.                          |                                                                             |

Figure 17. Odd-Lot Dealer's Purchase Report Slip

Recording of purchase by the odd-lot house of Smith & Brown from the commission house of Jenkins & Co., of 25 shares of Engineers Public Service at 49¼.

sell such odd-lots of stock as are offered to him or sought from him. The price at which he makes the sale of 20 Sun Oil depends upon special conditions presently to be treated. But he learns from his book whether or not his firm already owns any Sun Oil common stock. In case, to use his own phrase, his house is "long" of 54 shares, he can, of course, sell 20 of them without needing to buy any of them. But if, on the contrary,

his firm has less than the 20 shares required, it may be necessary for him to sell this amount short to the purchasing broker for the time being, and cover the transaction afterwards by purchasing a 100-share lot of the stock from some commission broker or floor trader in the open market.

Sometimes odd-lot houses may be temporarily long of thousands of shares of a stock, and at other times carry very little. But in general, of course, the odd-lot houses do not conduct their business like a retail grocery shop, and keep "stocked up" with a variety of shares as the latter does with different kinds of provisions. There is no need of such a cumbrous method of doing business, since the odd-lot dealer is standing in the very center of the world market for Sun Oil stock, and he can purchase as much as he needs of it in 100-share lots at any time, simply by making a bid for it.

**Usefulness of the Short Sale.**—The fact that the odd-lot dealer, if he is to do his work efficiently and quickly must constantly take a short as well as a long position in the market, furnishes one of the clearest examples of how very necessary the short sale is to a well-balanced and highly organized market.<sup>5</sup> For if the odd-lot dealer could not become short of a stock just as readily as he can accumulate and become long of it, the odd-lot machinery of the Exchange would be thrown out of balance and prevented from rendering its present vast service to thousands of small investors all over the nation. As in the case of any other short seller, of course, the odd-lot dealer incurs the risk of loss if the stock advances, and a chance for profit if it declines, between the time of the sale and that of the subsequent purchase. But, unlike the ordinary speculator, the odd-lot dealer often may take a position in stock, whether long or short, not necessarily when he wants to, but at times when his customer-broker desires to sell to him or purchase from him.

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<sup>5</sup> See Chapter VII, p. 197.

The 20-share certificate, after it is obtained from the transfer office, is sent to the purchasing broker, who at once pays for it. The broker then delivers the certificate to his customer, and the transaction is concluded.

**A Sale of an Odd-Lot.**—When the customer wishes to sell 10 shares of Union Carbide stock, the process described above is simply reversed. The selling order is sent over the telephone and through the tubes to the odd-lot dealer, who buys the shares in accordance with instructions accompanying the order. When by such purchasing of many small lots the odd-lot dealer becomes long of, or accumulates, 100 shares of Carbide stock, he can, of course, either hold them temporarily, or else sell a round lot of 100 shares of the stock to someone at the Carbide post. In this operation, the odd-lot dealer may sometimes stay long of the given stock in varying amounts and for varying periods of time, with the danger of loss if its price declines and a chance for profit if its price rises in the meantime.

**Work of the Transfer Office.**—The methods employed in exchanging odd-lot certificates for 100-share certificates also deserve a word in passing. This exchange is, of course, effected at the transfer office or agency of the corporation in question.<sup>6</sup> For greater convenience, every listed company has two different kinds of share certificates—one for even 100 shares, and the other for less than 100 shares.

When, for example, the odd-lot dealer has accumulated by purchase 100 shares of Pennsylvania Railroad, in four lots—let us say—of 17, 13, 20, and 50 shares, he can send these four odd-lot certificates to the transfer office of the Pennsylvania Railroad; and this office, after destroying the odd-lot certificates, will issue to the odd-lot dealer a single 100-share certificate. The reverse process takes place when the odd-lot dealer wishes to obtain odd-lot certificates to make deliveries of odd-lots which he has sold. If, for instance, he has sold odd-

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<sup>6</sup> See Chapter IV, p. 95.

lots of 3, 14, 8, 20, 25, and 30 shares of U. S. Steel preferred, he sends to the transfer office a 100-share certificate of that stock; this is thereupon canceled, and the odd-lot dealer receives in exchange six odd-lot certificates, each for the stated number of shares.

This process of exchanging odd-lot certificates for 100-share certificates is not always necessary, and consequently by no means invariably employed. Odd-lot certificates aggregating 100 shares are considered a "good delivery" for a 100-share sale of stock, and frequently odd-lot houses will deliver to a purchasing commission broker odd-lot certificates to the total amount of 100 shares, instead of a 100-share certificate. Nevertheless, the latter has the right to demand that the stock be delivered to him by transfer—in which case he would, of course, get a 100-share certificate.

Deliveries of odd-lot certificates to out-of-town customers which require transfer into a new name are frequently delayed by the operations of the transfer offices. The odd-lot dealer puts the stock into transfer, but cannot get it out again quickly to deliver to the buying broker. Meanwhile, the out-of-town customer becomes impatient and is apt to blame the odd-lot dealer for a delay inevitable with registered securities requiring transfer.

**Deliveries, Commissions, and Profits.**—It should be noted that the odd-lot house never comes directly into contact with the public, but deals with it only through the commission brokers, who in odd-lot transactions act as middlemen. In consequence, the odd-lot dealer delivers the certificates of the odd-lots of stock which he has sold to the commission broker, who in turn delivers them to his customers. Similarly, the odd-lot certificates which the customers sell, come to the odd-lot dealer only through the commission broker. The commission broker charges a commission for his services to the odd-lot customer exactly as in the case of the purchase or sale of round lots of stock. The exact amount of this commission varies

among the different brokerage houses and according to the number of shares bought or sold; in many cases, the minimum commission charge is \$2, although some firms would make a higher charge. The broker cannot make any other profit from an odd-lot transaction, however, since he is not a dealer, but merely his customer's agent. The odd-lot dealer, on the other hand, being a dealer and not a broker, cannot charge any commission for his services, but must rely for his profits on the difference between the prices of his sales and his purchases.

**Determining the Price.**—With this background of the mechanical side of the odd-lot business, we are now in a position to consider how the prices at which such typical purchases and sales as those discussed above are determined. The price at which odd-lot houses can profitably and regularly afford to deal in odd-lots of stock depends fundamentally upon the current market prices for the sales of the same stocks in 100-share lots, as well as upon such limitations as may be placed upon the buying or selling orders of the customers. The activity of the particular stock is also an essential factor in this question of price, as we shall see.

In the case of the most active stocks it is customary for odd-lot dealers to sell odd-lots at  $\frac{1}{8}$  above, or buy them at  $\frac{1}{8}$  below, the next sale of 100 shares. Thus, an odd-lot dealer in receipt of an order to make a purchase or sale of 20 shares of Bethlehem Steel common will wait about the post where this stock is traded in until the next 100-share transaction occurs. If 100 shares of Bethlehem Steel should be sold—let us say—at 95, the odd-lot dealer would under the circumstances sell 20 shares for  $95\frac{1}{8}$ , or buy them for  $94\frac{7}{8}$ .

**Transactions Made at Bid and Offer Prices.**—Since on this basis odd-lot trading involves waiting for a sale of 100 shares, another method is sometimes resorted to, which avoids the delay. In most active stocks the odd-lot dealer will buy or sell at once, if he is allowed to buy the odd number of shares



from his customer at the bid price, or sell them to his customer at the asked price. If, for instance, the odd-lot dealer receives an order to buy or to sell 20 shares of Rand Mines *at once*, he hastens to the appropriate post and finds that the stock is offered at  $35\frac{1}{2}$ , and that  $34\frac{7}{8}$  is bid for it. Without waiting for the brokers who are bidding for or offering the stock to effect a compromise and make a sale at some price between these two figures, the odd-lot dealer may buy the 20 shares of Rand Mines from the commission broker at the bid price of  $34\frac{7}{8}$  or may sell them to him at the asked price of  $35\frac{1}{2}$ . Unless, however, the odd-lot dealer is directed to obtain an instant execution based on these bid and asked prices, it is usually understood that an order for odd lots should be executed  $\frac{1}{8}$  from the price established by the next 100-share sale.

**“Quarter Stocks.”**—Naturally the higher the price of a stock, the greater become the financial commitments and risks of the odd-lot dealers who purchase or sell it. For this reason, odd-lot dealers make it a practice to sell high-priced shares at  $\frac{1}{4}$  instead of  $\frac{1}{8}$  over, and to buy them at  $\frac{1}{4}$  instead of  $\frac{1}{8}$  under, the next 100 share sale. An alternative sometimes preferred by customers for odd-lots of such stocks is to purchase them from the odd-lot dealer at  $\frac{1}{8}$  over the “asked” quotation, and to sell them to him at  $\frac{1}{8}$  under the “bid” quotation.

The point of differentiation between what constitutes high and low priced stocks for the purpose of odd-lot dealings, is subject to variation according to current circumstances. The Stock Exchange itself does not intervene in this situation, since it naturally could not undertake to dictate to its members the prices at which the latter can deal on their own account.

**Odd-Lot Transactions “at the Opening.”**—In determining prices for odd-lot transactions, confusion occasionally arises because of the 100-share quotations themselves. When a market order—that is, an order which does not fix any specific price at which the odd-lot will be sold or bought—is given

for an odd-lot by a customer before the opening of the market, it is executed by the odd-lot dealer at  $\frac{1}{8}$  (or with special securities,  $\frac{1}{4}$ ) from the first 100-share sale that day—or, as it is commonly called, the “opening” sale. It sometimes happens, however, that this opening sale of 100 shares, upon which the price for the odd-lot is based, is difficult to determine. In active markets many orders accumulate in the commission brokers’ offices overnight for execution at the opening. There may, for example, be a large crowd waiting around the post of an active stock like Bethlehem Steel common at 10 A.M. when the gong announcing the opening is rung. In the immediate roar of bids and offers two or more simultaneous first sales might occur, at slightly different prices.<sup>7</sup> If no one can tell exactly what the opening price for 100-share lots is, naturally the odd-lot dealer cannot tell what price he should charge or pay his customers. In such cases, however, the representatives of the various odd-lot houses about the Bethlehem Steel post quickly determine a fair opening price for Bethlehem Steel by averaging the various simultaneous quotations. If two opening sales for 100 shares of Bethlehem Steel common, for example, should occur simultaneously at 95 and  $95\frac{1}{4}$ , in all probability the opening price would be declared to be  $95\frac{1}{8}$ , and on this price odd-lot purchases or sales of Bethlehem Steel common would be based.

Occasionally, too, orders come to the odd-lot dealers to buy or sell an odd-lot of stock “at the close.” Such orders are ordinarily executed on the final bid and asked quotations of the day. It would, of course, be impracticable to execute odd-lot orders at  $\frac{1}{8}$  from the last sale of 100 shares of the given stock that day, since with inactive stocks the last sale may occur early in the morning. Furthermore, the last sale of a stock might be made at 50, while the closing bid and offer for it might be 48–49. The odd-lot dealer must also reserve the right to sell odd-lots against full lots, and vice versa, and he cannot be

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<sup>7</sup> See Chapter VIII, p. 218.

certain that his sales will be the last of the day. The only practice which is just to everyone is, therefore, to execute orders at the close on the final bid and asked quotations.

**Limited Orders in Odd-Lots.**—Another set of misunderstandings is occasioned by limited orders for odd-lot purchases or sales. A limited order, as we have previously noticed, is one which fixes a certain price at which a customer will buy or sell a stock. A buyer may stipulate, for example, that he will not pay more than 75 for the 25 shares of Pennsylvania Railroad he wishes to purchase. Similarly, an investor who has 30 shares of Eastman Kodak, may instruct his broker to sell it if he can get 250. Such limited orders are always executed at the price limits set, and as soon as the appropriate price for 100-share lots is reached, that is, as soon as 100 shares of Pennsylvania sell as low as  $74\frac{7}{8}$ , or 100 shares of Eastman Kodak sell as high as  $250\frac{1}{4}$ , the execution of these orders—one at  $\frac{1}{8}$  and the other at  $\frac{1}{4}$  from the 100-share sales—is automatically effected.

Yet even this uniform rule occasionally leads to misunderstandings. For example, a customer might give his order to purchase 20 shares of General Motors at 80. After selling at 81, General Motors might drop on the next 100-share sale to 79, thus moving through 80 without actually recording a sale at that price. In such a case the odd-lot dealer would sell the 20 shares to the customer's broker at 80. The customer might object that the next sale had really been made at 79, and that therefore he should get his 20 shares at  $79\frac{1}{8}$ . Yet he has purchased the stock and received it at the price he himself has named. If the order to purchase 20 shares of General Motors at 80 is received by the odd-lot dealer and is therefore "in the market" *before* the sale of 100 shares at 81, it is considered a bid for stock and is therefore executed subsequently at its limit of 80. But if this 20-share order comes into the market *after* the sale of 100 General Motors at 81, it is then executed  $\frac{1}{8}$  away from the next sale, or at  $79\frac{1}{8}$ . In other words,

limited orders for odd-lots are executed at their limits, except in cases where they can be executed at  $\frac{1}{8}$  away from the first subsequent sale.

Furthermore, if his order limited at 80 were permitted to be executed at  $79\frac{1}{8}$ , he might in many cases be obtaining better treatment on his 20 shares than if he had ordered 100 shares. For had he ordered 100 shares at this particular time, his order would have most likely been executed at 80, particularly if it had been given to a specialist to execute. Such practice would work an obvious injustice to buyers of 100 shares as compared with buyers of odd-lots. And if it generally proved more advantageous to buy or sell stocks in odd-lots rather than in 100-share lots, it would be impossible to maintain the trading unit of 100 shares, the necessity for which has already been pointed out.

In case, however, the price of General Motors stays above 80 throughout the day on which the order is given, but opens the next morning at  $79\frac{1}{2}$ , or below the limit of 80 set by the customer, the latter would then get his 20 shares of stock for  $79\frac{5}{8}$ , or  $\frac{1}{8}$  above this first sale; for this price, although less than his limit of 80, is nevertheless slightly higher than the price the 100-share customer at that moment would have to pay.

Stop-loss orders are executed  $\frac{1}{8}$  (or  $\frac{1}{4}$ , in case of a high-priced stock) from the first 100-share sale which puts the stop order in force. To take the case of a customer who puts in a stop-loss order to sell 50 shares of U. S. Steel at 200, if Steel sells first at  $200\frac{1}{4}$  and then at  $199\frac{1}{2}$ , the order is executed at  $199\frac{1}{4}$ .

**Mechanical Limitations of the Ticker Service.**—Many customers after placing orders with their brokers to purchase or sell odd-lots of stock linger in the offices to watch the ticker's record of 100-share sales (Figure 18) upon which, as we have seen, the prices they must pay or take for their odd-lots is

based. Occasionally such customers have been confused and misled by mechanical limitations of the stock ticker.<sup>8</sup>

Sometimes a large volume of sales has made it physically impossible for the old ticker machine to keep abreast of the market, and consequently, the tape has sometimes lagged considerably behind the market, and closing prices have sometimes not appeared upon it for half an hour or even more after the

|                       |                 |              |             |              |          |         |
|-----------------------|-----------------|--------------|-------------|--------------|----------|---------|
| T                     | GM              | PUB          | CJ          | AFW          | C        | NW      |
| 11.18½.4.¾.2.19       | 44¾             | 99¾          | 34¾         | 3s74         | 51¼..... | 74¾.75. |
| CTM                   | UP              | SX           | J           | KN           | X        |         |
| 2s200½.2s200          | 222¾.           | 118¾...      | 74.5s½.20.¼ | 5.40¼.       | 6s8      |         |
| JMP                   | CIT.WARR        | U            | X           | T            |          |         |
| 2s82.81¾.2s½.2s¼.3s81 | 6¾.....         | 2.34¾        | 2.67¾       | 20¾.         |          |         |
| R                     | AC              | PPB          | GM          | X            |          |         |
| 42¾.43.5s42¾.2s43     | 2.28¾.12.28.2.¼ | 2s59¾...     | 2.44¾       | 3.8          |          |         |
| T.RT                  | X               | VA           | WX          | G            | UN       |         |
| 20s19¾                | 67¾.            | 99¼.99.4.98¾ | 5.47½       | 13¾.2.½.3.½. | 6s47.5   |         |

Figure 18. Specimen Sections of Stock Ticker Tape

Top row records sales of 1,100 shares of American Telephone & Telegraph at (2)18½, 400 more at (218)¾ and 200 at (2)19; 100 General Motors at 44¾; 100 Public Service of New Jersey at 99¾; 100 U. S. Pipe & Foundry at 34¾; 300 American and Foreign Power at 74; 100 Anaconda Copper at 51¼; 100 Chicago & Northwestern Railway at 74¾, and 100 more at 75.

Second row from top records sales of 200 J. I. Case Co. at 200½, and 200 more at 200; 100 Union Pacific Railroad at 222¾; 100 Southern Pacific at 118¾; 100 Standard Oil of New Jersey at 74, 500 more at 74¾, and 2,000 more at 74¾; 500 Kennecott Copper at 40¾; and 600 U. S. Steel at (16)8.

Third row from top records sales of 200 Johns-Manville at 82, 100 more at 81¾, 200 more at (81)½, 200 more at (81)¾, and 300 more at 81; 100 Commercial Investment Trust warrants at 6¾; 200 United Corporation at 34¾; 200 U. S. Steel at (1)67¾; and 100 American Telephone & Telegraph Co. at (2)20¾.

Fourth row from top records sales of 100 Radio Corporation at 42¾, 100 more at 43, 500 more at 42¾, and 200 more at 43; 200 American Can at (1)28¾, 1,200 more at (1)28, and 200 more at (128)¾; 200 Pan-American Petroleum B at 59¾; 200 General Motors at 44¾; and 300 U. S. Steel at (16)8.

Bottom line records sales of 2,000 American Telephone & Telegraph rights at 19¾; 100 U. S. Steel at (1)67¾, and 100 more at (167)¾; 100 Vanadium Co. at 99¼, 100 more at 99, 400 more at 98¾; 500 Westinghouse Electric at (1)47½; 100 Consolidated Gas at (1)13¾, 200 more at (113)¾, and 300 more at (113)¼; and 600 Union Carbide & Carbon at (7)4¾, and 100 more at (7)5.

<sup>8</sup> See Appendix VI d.



closing hour of 3 P.M. Naturally, too, the stock tape is more apt to be delayed in printing quotations for active than for inactive securities. Owing to such occasional delays the customer who has just sent in a market order for 10 shares of Bethlehem Steel may see on the tape some minutes later a record of the sale of 100 shares of Bethlehem at 93. He will naturally suppose that he must pay  $93\frac{1}{8}$  for his stock, yet because of the slowness of the ticker the 100-share transaction at 93 may have occurred long before the odd-lot dealer on the Exchange has even received the customer's order. Thus, while the dealer is waiting for the next sale the customer imagines that the whole transaction has been concluded. If the next sale should be at  $93\frac{1}{2}$ , the customer must, of course, pay  $93\frac{5}{8}$  for his stock, and unless he realizes that the ticker was behind the sales, he will be apt to conclude hastily that he is paying  $\frac{1}{2}$  too much. If, on the other hand, the next sale is at  $92\frac{1}{2}$  and he gets his stock for  $92\frac{5}{8}$ , he may wonder whether a mistake has been made, but—at least according to the general run of human nature—he probably will say nothing about it.

**Misunderstandings Regarding "Bunched Sales."**—Sometimes, too, a number of sales of one security are run off on the tape together, although in reality sales of other stocks have occurred between them. This occasional "bunching" of sales of one stock on the tape not only creates the illusion that stock market activity proceeds in violent outbursts of dealings in one after another issue, but it also is apt to mislead the odd-lot investor as to the exact 100-share quotation upon which the price of his odd-lot transaction has been based.

Originally this "bunching" of sales on the tape arose from the fact that sales were reported to an operator of an electrical key-board who printed them on the ticker, from several different stations on the floor; being after all flesh and blood, this operator in an active market would be compelled by the system under which he worked to print reports on the tape from each

station in succession rather than in precise chronological order from all stations at once.<sup>9</sup>

When this key-board operator and the four other operators who "fed" him quotations were replaced by a centralized mechanical device, it was thought that this defect of "bunched" sales had been at last eliminated. But the vastly increased volume of dealings in recent years has overburdened even the mechanical electrical interrupter which has replaced the old key-board operator, with the result that "bunched" sales on the tape still occur, although less frequently than formerly. The new stock ticker instrument, by enabling speedier dispatch of quotations, has, however, further obviated this problem.

When sales are "bunched" on the tape, it is naturally very difficult for the odd-lot investor to determine which of these sales is the basis of his odd-lot transactions. Sometimes, too, he jumps to the conclusion that many sales in the given security have suddenly occurred, and that the odd-lot dealer has taken advantage of this fact to select the highest of them as a basis for selling and the lowest for the basis of buying, to and from the brokers who represent the public. To anyone familiar with the mechanism of reporting sales on the tape, the fallacy of such a conclusion should be apparent. Although the stock ticker system of the New York Stock Exchange is by all means the most efficient price reporting mechanism in the world, and although the Exchange has spared neither pains nor expense to improve it as rapidly as science and invention have permitted, it is still true that the system fails of perfection and that occasionally allowances must be made for its limitations.

In addition, it is unfair to blame the ticker for all the delays between the giving of an odd-lot order and the appearance on the tape of the next 100-share sale upon which its execution is based. In active markets, especially at the opening, considerable delays have sometimes occurred in the transmission of an

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<sup>9</sup> See Appendix VIId.

order from the broker's office to the appropriate post on the Exchange floor, because of unusual pressure on telephones and on the pneumatic tube system. Recently, a new system for sorting and dispatching odd-lot orders on the Exchange floor in preparation for the opening of the market at 10 A.M. has considerably relieved, without however completely obviating, the dangers of such delays in the transmission of odd-lot orders to the odd-lot dealer.

**Adjustment of Errors in Odd-Lots.**—If at any time a customer has any reason to question the price on the purchase or sale of an odd-lot, he will find the odd-lot house always willing to meet him more than half way. Indeed, each of the large odd-lot houses maintains an extensive department of adjustments, which thoroughly investigates any disputed bargain, and on the basis of the conditions existing at the time of the complaint makes such adjustment as is fair to all parties to the transaction. This department has a ticker with a stamping clock attached which stamps the current time on the tape, minute by minute, all day long. Thus, the exact time at which every transaction was reported on the tape can be easily ascertained. Moreover, the odd-lot order, immediately on its receipt by the commission broker's telephone clerk on the Exchange, is usually stamped with a time clock. Between these two records it is thus possible, as a rule, to determine with some degree of accuracy the actual time at which the given 100-share sale took place, and to discover if there has been any error made in establishing the price of the odd-lot transaction based upon it. If for no other reason, the keen competition for business between the various odd-lot dealers on the Stock Exchange insures a painstaking and adequate effort to give their customers the greatest possible satisfaction. Unfortunately, however, the liberal attitude of odd-lot firms in endeavoring to give the public the benefit of the doubt on adjustments of the sort, is sometimes taken by investors to indicate an acknowledgment of error on the part of odd-lot firms; thus, in the matter of adjust-

ments, the odd-lot dealer is apt to be "damned if he does and damned if he doesn't."

**Risks of Loss to the Odd-Lot Dealer.**—It has been pointed out that the odd-lot dealer must temporarily go short of stock when his customer buys, and go long of it when he sells. One inevitable disadvantage under which the odd-lot dealer must labor is the constant risk of suffering actual losses by sudden rises or declines in the prices of these stock commitments, whether long or short.

The odd-lot dealer has to take these losses constantly, and frequently they benefit his customer. To illustrate, in a typical instance a customer ordered, with instructions to "wait for sale," 50 shares of a stock, for which at the time 13 was bid and 18 asked. Since the next sale occurred at 14 he got his stock for  $14\frac{1}{8}$ . But on the sale following that, the price had risen to 18. Had the customer ordered 100 shares instead of 50 he might have had to pay 18 for it. Furthermore, the odd-lot dealer was faced with a loss of  $3\frac{7}{8}$  in covering the short sale which he had made to obtain the 50 shares for the customer. Such cases where the odd-lot customer gets off much better than either the 100-share customer or the odd-lot dealer are by no means rare. Conversely, in the event of a rapidly sinking market, the seller of odd-lots may often have a similar advantage over both a seller of 100-share lots or the odd-lot dealer.

In this connection it must be remembered that the odd-lot dealer is always willing to sell or buy odd-lots of stock. In less than 100-share orders his function is akin to that of the "jobber" in the London Stock Exchange; he is the core of the whole market, in which the commission broker is a middleman. There is keen competition between the odd-lot houses on the Exchange, and to hold his business the odd-lot dealer must constantly assume the risks of his calling.

**Expenses of the Odd-Lot Business.**—Apart from the risks which must be taken, the odd-lot dealer is in some respects

under greater expense in conducting his business than is the average commission broker. The successful execution of odd-lot orders, to begin with, calls for a large force on the floor of the Exchange. One large odd-lot house engages about 40 Exchange members first and last to transact its floor business; the aggregate capital tied upon in Stock Exchange seats alone is thus very large. In addition, since large numbers of odd-lot certificates are continually in process of transfer, much capital of an odd-lot house is regularly tied up in consequence. Moreover, since the odd-lot dealer is a principal and not an agent, he must himself pay the Federal and New York State transfer tax on every share he sells, instead of passing this charge on to the customer, as the commission broker can do and does.<sup>10</sup>

In addition to this, the odd-lot house must bear office expense in some respects far heavier than the average commission broker. One large odd-lot house is compelled to maintain a force of about 1,200 clerks, and to occupy half-a-dozen floors in a large and expensive office building in the Wall Street district. The necessity for constantly splitting 100-share certificates into odd-lot certificates, and vice versa, alone demands a large and competent clerical force in the transfer department of an odd-lot house. Furthermore, since only 100-share transactions, or multiples of 100, are cleared through the Stock Clearing Corporation, the odd-lot house must handle all its own clearances itself—an even greater task.<sup>11</sup> The bookkeeping in odd-lot houses, too, must cover thousands of small items, and must be kept rigorously up to the minute.

When these items of risk and heavy overhead expense are remembered, it is obvious that only a firm with unusually large financial resources, efficient management, well-trained help, and a large volume of the small orders in which it specializes, can hope to engage successfully in the odd-lot business. In the fifty odd years in which the odd-lot houses have been an impor-

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<sup>10</sup> See Chapter VIII, p. 207; Appendix VIIIb; and Chapter XV, p. 426.

<sup>11</sup> See Chapter XII, p. 316.



tant factor on the floor of the New York Stock Exchange, no odd-lot house has ever yet failed.

**Economic Significance of the Odd-Lot Business.**—In conclusion, something of a more general nature should be added concerning the broader economic significance of this system for the execution of odd-lot orders on the New York Stock Exchange. Small and individually inconsiderable as many odd-lot sales and purchases are, their aggregate amount is very large. It was recently estimated that, on the average, about 30% of the total sales made on the floor of the Exchange arose from odd-lot transactions. But this percentage naturally varies from time to time, and on certain occasions has amounted to possibly 60% or even more. To the small investor particularly, the Exchange is able through its odd-lot machinery to render a very real and far-reaching service. Its present odd-lot system has placed the retail buyer and seller more nearly upon a plane with the wholesaler in security dealings than is the case in almost any other line of modern business. The retail or odd-lot prices are founded directly upon wholesale or 100-share prices, and are, as we have seen, for the most part only  $\frac{1}{8}\%$  or  $\frac{1}{4}\%$  away from the wholesale prices. The New York Stock Exchange makes every effort to give the small investor and trader in odd-lots every essential protection which is afforded the buyer or seller of 100-share lots.

**The Odd-Lot Dealer as a Factor in Distribution.**—The odd-lot machinery of the Stock Exchange also renders no small assistance to the large listed stock corporations, in enabling them to achieve a broad and stable distribution of their shares among the investing public. Corporations have long realized that it was to their decided advantage to distribute their shares evenly in small amounts among many stockholders, rather than simply in large amounts among a comparatively few holders. Such indeed has been the general trend in the recent distribu-

tion of the shares of some old and conservative corporations.<sup>12</sup> The effectiveness of the Exchange odd-lot system to this end is sufficiently obvious to need no further comment. The steady increase in the odd-lot business shows the growth of the investment class in this country, and is to be regarded as one of the healthiest of economic indications of our financial endurance and stability.

A further benefit rendered by the odd-lot system arises from the fact that it broadens, steadies, and strengthens the whole stock market. We have seen that if many small investors buy odd-lots from the odd-lot dealer, he is in turn led to buy round lots in the 100-share wholesale market. Similarly, extensive selling of odd-lots soon exerts pressure on the wholesale market, as the odd-lot dealer liquidates there in 100-share lots the smaller lots sold to him by the public. Thus the force of odd-lot purchases and sales is quickly imparted to the general 100-share market. And it is a general truth that the broader the market can be made, the more satisfactory its prices will be to everyone.<sup>13</sup>

#### **Odd-Lot Purchases in Declining or Rising Markets.—**

The economic advantage of the large odd-lot interest in the market is particularly manifest in declining markets, which are frequently stabilized by heavy odd-lot buying. There is no more confirmed bargain-hunter in the financial field than the odd-lot purchaser. Odd-lot buying on declines in the market is one of the principal factors which steadies falling prices and restores equilibrium, and with it public confidence in American business and American enterprise.<sup>14</sup> A large proportion of odd-lot buying represents purchases of stocks in small amounts for permanent investment. The odd-lot certificates thus find their way into the strong boxes of a vast number of only moderately wealthy but thrifty and ambitious people in all parts of the country.

<sup>12</sup> See Chapter IV, p. 119.

<sup>13</sup> See Chapter II, p. 48.

<sup>14</sup> See Appendix IXa.

Similarly, in a wild bull market when the price structure is becoming top-heavy and dangerous, the odd-lot investor tends to liquidate his small lots of stock and take his profit. The aggregate effect of this tendency is to restrain the rising tendency of the market at times when such restraint is most salutary from the economic standpoint.

Thus, by extending the facilities of the Stock Exchange securities market in this way to millions of small investors throughout the United States and even beyond its borders, the odd-lot dealer not only makes it a better wholesale market than it could otherwise be, but also renders it a constant force in forwarding the democratization of both American finance and American society.

## CHAPTER X

### THE BOND MARKET

Our survey of Stock Exchange operations thus far has dealt primarily with dealings in shares, and little has been said concerning the Exchange bond market. In their general methods and functions, the bond and share markets on the Exchange are much alike. But as share dealings on the Exchange occur in much greater volume than bond dealings, much more extensive facilities are required on its floor for the former than for the latter.

As an earlier chapter<sup>1</sup> has pointed out, bonds represent debts while shares represent equities, and bondholders are creditors while shareholders are really partners. Also, bonds usually must be repaid by some fixed maturity date, while usually share issues represent theoretically perpetual equities. Thus bonds, as obligations of some government or company, are inherently simpler and as a rule more definite than shares, and consequently less dependent upon speculation during their distribution.

**Classes of Bonds.**—Bonds can be divided into two general classes—mortgage bonds which are secured by a mortgage of some physical asset of the issuing debtor organization, and debenture bonds which are not so secured and simply evidences of debt.

There are practically as many kinds of mortgage bonds as there are different varieties of mortgages, and sometimes the exact order of precedence among different mortgage issues as claims against assets or earnings is difficult to determine. Mortgage bonds, particularly in the railroad field, are also

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<sup>1</sup> See Chapter I, p. 17.

classified according to the nature of the assets securing them; thus, within this single industry there are "land grant" bonds, "terminal" and "bridge" bonds, etc. With collateral bonds, the mortgage is placed upon securities rather than directly upon physical property. Weak government bonds are sometimes specially secured by certain sources of revenue—such as port or internal taxes—but because of this fact they are not called mortgage issues.

Debenture bonds are not thus secured by any mortgage, or the pledge of any single source of income. The best government bonds, being claims against all rather than specified assets and revenues, are debentures. Our American railway reorganizations have also produced a peculiar and sometimes riskier type of debenture—the "income" or "adjustment" bond, which according to the terms of its indenture, needs to pay its interest only when the company earnings are sufficient to permit it, somewhat according to the manner of a preferred stock. Finally, "convertible bonds"—as their name implies—can under specified conditions be converted at the option of their holders into the stock of the issuing company. When this conversion privilege makes such an exchange profitable, the price of the bonds and the stock into which they are convertible will fluctuate together, owing to the rise of arbitrage between them. In such securities, regular arbitrage sometimes occurs on the New York Stock Exchange between its bond market and its stock market.

**Form of Bonds.**—Practically all American bond issues are available in the bearer form, with coupons attached. "Inscribed" bonds, after the British fashion, are unknown in this country.<sup>2</sup> Sometimes, however, the holder of a bearer bond is given the privilege of converting it into the registered form, either in respect to interest or principal, or both. But by no means all, or even most, American bond issues convey this privilege, and even where they do, it is not often availed of by

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<sup>2</sup> See Chapter I, p. 24.



the bondholders. In some cases, indeed, American bond issues are issued both in bearer and registered form, but are not fully interchangeable; in such cases, quotations for each form must not only be separately made, but may differ somewhat from each other.

American bearer or coupon bonds of course require no transfer and pass by delivery, since they state that the given debtor will pay interest and repay principal "to bearer." While bearer bonds thus avoid delays, formalities, and expenses of transfer and are thus more easily negotiable, they also subject their holder to greater danger if he is dispossessed of them by theft or loss.<sup>8</sup> Payment of interest is obtained upon them by cutting off the attached coupons when they are due, and collecting their amounts through a bank or a brokerage house.

An American registered bond, on the other hand, is payable to the individual or institution whose name is inscribed on its face; like the American registered share certificate, therefore, such a registered bond requires transfer when this ownership changes. To effect such transfer the registered bond certificate, like the registered share certificate, has an assignment form printed on its back, which the holder can assign in blank. Since registered bonds have no coupons attached, interest is periodically remitted to their nominal holders by check, as with registered shares. At maturity the holder of a registered bond must present it properly transferred to bearer before its principal amount can be paid to him.

When a broker or dealer effects a sale in the bond market on the New York Stock Exchange, it is understood that the bargain is for a bearer bond, unless the contract specifically was made for a registered bond. Separate quotations are made for the two forms of bond, as the one is not a good delivery for the other. Since the primary price is usually made for the bearer bond, the price for a registered bond of the same issue is apt to prove a little higher to the purchaser and a little lower to the seller, than this current price for the bearer form.

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<sup>8</sup> See Chapter I, p. 28, and Appendix VI d.

**Bond Listings.**—As of January 1, 1930, there were listed upon the New York Stock Exchange<sup>4</sup> 1,543 separate bond issues possessing an aggregate par or nominal value of \$49,058,099,434 and an aggregate market value of \$46,892,458,780. The following tabulation classifies these totals among their principal subdivisions:

| BOND AMOUNTS LISTED<br>(as of January 1st, 1930) |        |                  |                  |
|--------------------------------------------------|--------|------------------|------------------|
|                                                  | Issues | Par Values       | Market Values    |
| U. S. Federal.....                               | 18     | \$12,098,586,130 | \$12,362,647,240 |
| U. S. Subdivisional.....                         | 47     | 889,323,962      | 885,266,796      |
| Total U. S. Government.                          | 65     | 12,987,910,092   | 13,247,914,036   |
| Foreign National.....                            | 106    | 15,828,871,109   | 15,151,908,286   |
| Foreign Subdivisional.....                       | 97     | 918,076,848      | 793,630,187      |
| Total Foreign Govern-<br>ment.....               | 203    | 16,746,947,957   | 15,945,538,473   |
| Total Government.....                            | 268    | 29,734,858,049   | 29,193,452,509   |
| U. S. Railways & Equipments                      | 688    | 10,234,047,261   | 9,559,076,049    |
| U. S. Utilities.....                             | 201    | 3,457,684,941    | 3,308,602,080    |
| U. S. Industrial & Misc.....                     | 220    | 3,046,639,316    | 2,814,400,819    |
| U. S. Cos. Operating Abroad.                     | 37     | 371,885,045      | 273,904,414      |
| Total U. S. Bonds.....                           | 1,211  | 30,098,166,655   | 29,203,897,398   |
| Total Foreign Bonds....                          | 332    | 18,959,932,779   | 17,688,561,382   |
| TOTAL BONDS.....                                 | 1,543  | 49,058,099,434   | 46,892,458,780   |

**Speculative Aspects of Bonds.**—Since bonds constitute an obligation to pay which takes precedence over shares as claims to income and assets, and since the terms of such payment are much more definitely determined with bonds than with shares, there is naturally much less speculation and less active turnover in the bond than in the stock market. For, as we have seen, the less certainty there is concerning values, the more inevitable is speculation as a method of obtaining an estimate of them.<sup>5</sup>

<sup>4</sup> See Annual Report of the President, 1929-30, p. 96.

<sup>5</sup> See Chapter V, p. 139.

However, it is a complete fallacy to think that bonds are not the objects of speculation, or that they are immune from speculative forces. Whenever the payment of interest or principal on a bond issue becomes really doubtful, speculative factors enter its market, and trading in it tends to increase. Similarly, a sudden change in short-term money rates, by creating a greater disparity between themselves and prevailing bond yields, may impart speculative price changes to the bond market. Also, when a very large bond issue is floated, its distribution, which may for the time being tax the resources of the market, may temporarily entail active trading and speculation. Moreover, when bonds are in the denomination of a foreign currency and marketed in America, any real disturbance in its foreign exchange rate with dollars may render such bonds active and speculative on the market. Convertible bonds may through their conversion privilege prove as speculative and active as the shares into which they are convertible. Finally, as economists have frequently pointed out and as many conservative investors of pre-war Europe have learned to their cost, bonds by virtue of being a definite money contract may be profoundly depreciated in actual value by currency inflation or rising commodity prices, since in such cases the actual buying power of the money which they involve will be considerably diminished. We must not, therefore, consider that speculation is absent from or unnecessary in the bond market, but only that it is not present there as extensively as in the stock market.

**The New York Bond Market.**—The New York bond market consists in reality of three different parts; these sometimes overlap and deal in the same bond issues, and sometimes maintain a distinct and exclusive character. The first section of the market exists between the underwriting and issuing houses and the investing public direct; its chief vehicle is the printed advertisements of new "offerings," and in any given bond issue it dominates distribution as a rule only during the

life of the syndicate agreements under which the new security was issued.

The second section of the New York bond market is called the "outside" or "over-the-counter" market, while its third section consists of the bond market on the New York Stock Exchange. The buying and selling in the "outside" market is conducted primarily over the telephone between New York bond dealers and brokers, with dealings also entering the market by telegraph or long-distance telephone from other cities in the country, or by cable from abroad; to a minor extent published advertisements also play a part here. There is no definite membership in this "over-the-counter" market; the leading New York participants in it are the insurance companies and savings institutions, trust companies, commercial and investment banks, under certain conditions the Federal Reserve Bank of New York, investment trusts and finance companies, individual estates, foundations or private capitalists, and numerous dealing and investment houses. Many member-firms of the New York Stock Exchange engage exclusively, largely, or only occasionally in bond dealings. The "outside" market, not being really organized, operates rather by custom and special negotiation than by enforceable rules and regulations.

The growth of this "over-the-counter" market was facilitated by the development of the telephone and the rise of powerful investment companies and firms in New York. It has become the great wholesale or jobbers' market for bonds, and is particularly notable for its large individual transactions. Compared with it, the bond market in the Stock Exchange is normally thin and concerned principally with retail transactions.

The development of the outside bond market was also due to the stable price tendencies of most good bonds; since bond prices do not fluctuate rapidly as a rule, there is time enough to negotiate over the telephone without much danger of "missing the market"—which would happen if the same thing were tried in active stocks. Thus a public and instantaneous organized

security market is at most times and with most issues not so necessary in bonds as in stocks. But although prices are usually communicated quickly in the outside market to dealers not parties to them, nevertheless facilities for public quotation are very rudimentary, and practically confined to often inaccurate newspaper quotations. Thus the bond market on the Stock Exchange regularly serves as a guide to the usually larger "over-the-counter" market, by reason of its highly perfected price-quotation system. Leading outside dealers sometimes make a market on the Exchange with relatively few bond sales, in order to establish prices as a standard for larger dealings outside. Also, these outside dealers sometimes accumulate small pieces on the Exchange and sell them again as a large block outside, or buy a large block outside and distribute it retail on the Exchange.

Due to the loose character of organization in the outside market, the latter is really a "fair weather" market, and it often proves incapable of maintaining dealings during periods of heavy liquidation, or when bonds for any other reason become specially active. At such times the main New York market in bonds is transferred to the Stock Exchange, whose highly perfected organization enables dealings to continue there even under very adverse and difficult conditions. For this reason it is by no means true that the Stock Exchange bond market is either unnecessary or unimportant, despite its comparatively small dealings in normal times.

**Evolution of the Stock Exchange Bond Market.**—While the proportionate importance of the Stock Exchange bond market in the whole market for bonds in New York has considerably declined since 1900, nevertheless the vast growth of the entire American bond business has resulted over this period in a steady expansion both of its volume of trading and its facilities.

Originally the Stock Exchange bond market was conducted by "calls," and although this system was superseded in shares



by the continuous market system many years ago,<sup>6</sup> it has been in comparatively recent times that a continuous market for bonds on the Exchange was first organized. Formerly at 11 A.M. the chairman of the Board (a contemporary official who used also to open and close trading on the Exchange) would call in succession the names of the various listed bond issues. As each bond was called, Exchange brokers and dealers would shout their bids and offers, and sales would be made. But the number of listed bonds finally became so great that this "call" system in the bond market became tedious and impractical. In its place, the present continuous bond market on the Exchange, and its "bond crowd," were established. Originally, and within the memory of bond traders now living, the bond dealer or broker could keep in his head all listed bond issues as he traded; with the great increase in listed bond issues, however, this became impossible, and thus central facilities for keeping bids and offers in the market had to be provided.

At first the continuous bond market was conducted on one side of the old Board Room. During the recent war period, extensive dealings in U. S. Government bonds led to the establishment of a separate trading booth for them; this was subsequently split into two different booths, one for Liberty bonds and other U. S. Government securities, and the other for foreign government and foreign company issues. Meanwhile the third and original section devoted to dealings in American railway and industrial corporation bonds considerably expanded. In 1922, when the New York Stock Exchange first occupied the additional floor in Wall Street (colloquially known on the Exchange as "the garage"), the bond market was more adequately housed here, together with additional facilities for share dealings. In 1928 the continual expansion of the security business led to new accommodations being prepared for the bond market in an additional trading room made as an extension from the old Board Room southward along New Street

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<sup>6</sup> See Chapter III, p. 67.



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Plate 8. The Bond Room



to Exchange Place. New and complete as these latest quarters of the bond market are, it would seem from past experience to be tempting Providence to prophesy just how long they may prove satisfactory and adequate in future years.

Recently, however, the growth in the bond business on the Stock Exchange has by no means kept pace with the growth of the business in shares, owing to the combination of such factors as the rapid retirement of the U. S. National Debt, the slackening of emergency European government financing, the popular preference for shares rather than bond investments on the part of the American public, the retirement of many commercial banks as bond buyers during periods of high interest rates, and the preference of American corporations for share rather than bond financing.<sup>7</sup>

**The Active Bond Market.**—The present Stock Exchange trading room for bonds extends from the old Board Room southward along New Street to Exchange Place (Plate 8). Its walls are lined with the telephone booths of Exchange members, which connect their offices with the market by private wire. It is divided by partitions which consist of additional telephone booths, into three separate markets—for active, inactive, and foreign bonds respectively.

The active bond market consists of a railed space where the "bond crowd" assembles. In its essentials it is conducted much as are the markets for active stocks, with open bidding and offering by Exchange members. However, the active bond market is provided with quotation clerks (employees of the Stock Exchange) who as a convenience to dealers note the price of bids and offers, with the name of the member who made them. In the active bond market, this giving of bids and offers to the Exchange clerks who handle the quotation cards in no way puts such bids and offers "on the floor." The practice serves simply to enable a particular broker to be reminded of them by the clerks, and to assist other brokers who

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<sup>7</sup> See Appendix Xb.

inquire the market. Since it sometimes happens that a dealer's bid or offer will thus be left with a quotation clerk and later, unknown to the latter, the dealer may have his order canceled or may perhaps conclude his transaction with another dealer in the crowd, the bids and offers left with quotation clerks are necessarily subject to confirmation before serving as a basis for dealing. On the side wall is a device which makes an enlarged reflection of the bond ticker tape visible to the bond crowd, and thus keeps it informed as to the general course of all listed bond prices.

The active bond market, as its name implies, deals in those American corporation bonds which are generally the most actively negotiated. When issues previously inactive become consistently active, they are transferred hither, and when previously active issues grow consistently inactive, they are removed to the inactive bond market.

**The Inactive Bond Market.**—The second section of the bond room is devoted to the inactive bond market, which is conducted on quite different principles. Many American company bonds are bought and sold on the Exchange so intermittently that there can be no "bond crowd" of Exchange members actively shouting bids and offers for them. Thus, the problem with such issues is to provide a means whereby the occasional bids and offers for them can automatically and regularly be kept "in the market." This is done in the inactive bond market by a hollow circle of steel filing cabinets (referred to as a rule as "cans") which are provided with flat indexed drawers, each devoted to a particular inactive bond issue. When a bid or offer for an inactive bond comes over the Exchange member's telephone, the telephone clerk at once fills out a card for it (Figure 19), which records the date, the name of the given Stock Exchange house, the name of the bond, the number of bonds involved, and the price. Cards containing offers are headed "SELL" and are printed in red, while those for bids are headed "BUY" and are printed in black. Orders good for



the day only are labeled "DAY ORDER" and are white, those good for a week "WEEK ORDER" and are blue, those good for a month "MONTH ORDER" and are pink, and those good until canceled "G.T.C. ORDER" and are yellow.

These cards, properly made out by the member's telephone clerk, are turned over to the Stock Exchange clerk who manages the filing case where the particular bond's bids and offers are filed. This clerk inserts the card among other similar cards in the drawer devoted to the particular issue. The cards lie flat, and their prices can be seen at a glance. The highest bid and the lowest offer are placed next each other, with the successively lower bids running away in one direction, and the successively higher offers in the other.

|                            |                            |  |                       |  |           |
|----------------------------|----------------------------|--|-----------------------|--|-----------|
| <b>BUY</b>                 |                            |  | <b>WEEK<br/>ORDER</b> |  |           |
| DATE <i>August 2, 1929</i> |                            |  |                       |  |           |
| NAME OF BROKER             |                            |  |                       |  |           |
| <i>Jenkins &amp; Co.</i>   |                            |  |                       |  |           |
| NO. OF<br>BONDS            | NAME OF BOND               |  |                       |  | PRICE     |
| <i>5</i>                   | <i>City of Rome 6 1/2s</i> |  |                       |  | <i>90</i> |

Figure 19. Bond Quotation Card

The placing of these cards in the "cans" in this market does constitute a "floor," and priority to the broker whose card is first to buy or sell each particular bond; the broker must stand ready to buy or sell the number of bonds stated on his card, and at the stated price.

**The Foreign Bond Market.**—Foreign government and foreign corporation bond dealings are handled in a third section of the bond trading room. Since some foreign bonds are active and others inactive, the arrangements in this foreign

bond market resemble those in both the active and inactive bond markets for American corporation bonds above described. Thus, in an open space the "foreign bond crowd" and its Stock Exchange quotation clerks handle active issues, while the same filing cases for bids and offers on cards as are used in the inactive bond market are also provided here for inactive foreign bonds. So greatly have Stock Exchange dealings in U. S. Government bonds dwindled since the years immediately following the war, that these are now handled in a rather inconspicuous corner of the room.

**Reporting System for Bond Prices.**—The system for reporting bond prices is very similar to that employed for share prices, except that because of the lighter volume of bond trading it is simpler in operation. In the bond room there are two stations for printing prices on the bond tape, one of which handles prices made in the active bond market, and the other those made elsewhere. As bond transactions are effected, reporters inscribe them on slips and take them to the appropriate station, whose operator proceeds to "typewrite" the appropriate symbols and figures on the tape in much the same manner as that already described in the stock market.<sup>8</sup> The bond and the stock ticker systems are entirely separate, and to obtain quotations for both, a commission brokerage office must have two different ticker machines. Bond tickers are not as widely distributed through the United States as stock tickers. Also, due to the less active character of the bond tape, bids and offers for bonds as well as price quotations for actual transactions are often printed upon it, and this practice has the result of widely extending the bond market on the Stock Exchange.

The ordinary unit of trading in the market is the single \$1,000 bond, and thus the Exchange bond market is really one for "odd-lots." Lesser denominations of \$500 or \$100 can also be bought or sold there, but usually at fractional variations

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<sup>8</sup> See Chapter VI, p. 168.

respectively above or below the price for the \$1,000 denomination. With Liberty bonds, small pieces are readily exchangeable the same day at the Federal Reserve Bank of New York for large pieces, or vice versa; this speedy facility for exchange permits small Liberty bonds to be bought and sold at very small adverse differences from their price on \$1,000 denominations. But with bond issues where this speedy facility for exchange does not exist to the same extent, it is necessary to deal in small pieces at a greater adverse difference in price. But this \$1,000 unit makes the purchase or sale of large blocks of bonds at the same price on the Exchange very difficult and often impossible, and as has been stated such large transactions usually occur in the outside market.

As to the variation of bids and offers for bonds, the Constitution (Rules, Chapter I, Sec. 9) states:

Bids or offers shall not be made at a less variation than  $\frac{1}{8}$  of one dollar in stocks, and  $\frac{1}{8}$  of 1% of the par value of bonds: provided, however, that the Committee of Arrangements may from time to time, in its discretion, determine that transactions may be made at variations less than the above, fixed by said Committee, on transactions in Foreign and Domestic Government bonds and notes, State, County and Municipal securities, short time bonds and notes of corporations, or on rights and stocks selling at a price of one-eighth or less, which said variations shall thereafter be in effect and be reported to the Governing Committee.

Thus the bulk of listed bonds are quoted by  $\frac{1}{8}$ s like most listed shares. During the period when Liberty bond trading was extensive on the Exchange, variations of  $\frac{1}{50}$  were permitted, though later these were altered to  $\frac{1}{32}$ .

Share prices on the New York Stock Exchange are quoted "flat"—that is, one pays no more than the quoted price for the given share on account of accrued dividends, which are compensated for by a rising price tendency as the date approaches as of which they are payable. Thus it is necessary for the Stock Exchange to announce the time at which shares will sell "ex-dividend," or without this accrued dividend to the new

buyer; at once after such time the price of the share normally drops by the amount of the current dividend payment. Most bonds on the New York Stock Exchange, however, are quoted "and interest"—that is, one pays not only the quoted price for the bond but an additional sum representing accrued interest upon it to date from the last coupon payment date. Thus a 4% bond with semi-annual coupon dates of January 1 and July 1, if quoted at 90 on April 1 will actually cost the purchaser \$900 plus about \$10 accrued interest for three months. The seller of course receives the accrued interest which the buyer pays.

Income and adjustment bonds, however, are dealt in on the Stock Exchange "flat" like shares, since like shares their interest does not have to be paid to avoid default. Bonds in default are also dealt in "flat," since in this case no interest payments are actually being made upon them. British Government sterling bonds listed on the New York Stock Exchange are also quoted "flat," to keep New York quotations as far as possible in accord with those of their primary market on the London Stock Exchange, which ordinarily quotes all its listed bonds "flat," instead of "and interest" like the New York Stock Exchange.

**Composition of the Bond Crowd.**—Each morning, before the opening of the market at 10 A.M., "the bond crowd" takes its stand in the bond market, and remains there dealing in bonds until the market officially closes at 3 P.M. week days, or at 12 noon Saturdays. The bond crowd is ordinarily composed of about thirty Stock Exchange members, most of whom specialize in bonds either as brokers or dealers, or both. Owing to the growth of the outside dealers' market in the last two decades, however, the Stock Exchange bond market has to an even larger proportional extent tended to become a brokers' rather than a dealers' market. Also, the former tendency there for certain Exchange members to specialize as dealers in certain bond issues is for the same reason tending to disappear. As

in the stock market, bond brokers execute orders on commission for other principals, while bond dealers buy and sell for themselves. Thus, as in shares, negotiability is through "the bond crowd" imparted to listed issues. The members of "the bond crowd," however, are not as completely specialized as are Exchange members usually dealing in the share market, owing to the lesser volume of bond than share dealings. Thus, most of the bond dealers are also brokers, and vice versa, although they are prohibited to act in both capacities in the same transaction here as in shares. Stockbrokers are sometimes unfamiliar with the technical features of bond dealings and in order to obtain the best obtainable prices for their customers, often "give out" their orders for bonds to bond brokers and share the commission with them, much as they "give out" orders in stocks which they cannot themselves handle adequately to the specialists and "two-dollar" brokers of the share market. For this reason, however, the ordinary Stock Exchange firm can buy or sell bonds for a customer with the same ease as shares, even though its floor member may himself be relatively unfamiliar with the technique of the bond market on the Exchange. There is no highly organized odd-lot machinery in the bond market, since the \$1,000 unit in a sense makes the whole market a retail one, and since in any case orders for \$500 and \$100 bond denominations are relatively infrequent.

**Execution of Bond Orders.**—Stock Exchange firms specializing in the bond business sometimes have a separate telephone booth or booths in each of the three sections into which the bond trading room is divided. When an order to buy or to sell an active bond comes in at the telephone, the telephone clerk makes out a slip for it as in the share market, and gives it to the Exchange member, who enters the active bond market (or the active part of the foreign market) to negotiate the purchase or sale. Usually he will first inquire the current bid and offer prices from the quotation clerk, although if the "crowd" is dealing actively in the issue he may proceed into it



directly. If there is difficulty in executing the order in this way by open bidding and offering, the broker may leave his bid or offer with the quotation clerk. The latter, not being a Stock Exchange member, cannot of course deal, but he does keep the market informed as to such orders in the market.

If, on the other hand, the bid or offer which comes to the telephone is for an inactive issue and "away" from its current bid and offer prices, the telephone clerk makes out a card for it, and turns this over to the clerk at the appropriate filing case. The latter inserts it in its proper place among other existing bids and offers for the same issue. But in case the bid or offer at the telephone is at such a price as to make speedy negotiation possible, the broker finds out the best offer (if he is bidding) or the best bid (if he is offering), by referring to the appropriate filing case cards. He then seeks out the other member who has made it, and whose name is inscribed upon the card, and negotiates the purchase or sale with him.

**Delayed Deliveries of Bonds.**—For many years most bonds were as a rule bought upon the New York Stock Exchange like stocks, for "regular way" delivery on the next full business day following the day when the contract on the Exchange was made; as with stocks, it was of course possible to deal in them upon buyers' or sellers' options to deliver within thirty or even sixty days, although this was rarely done except when American bonds held in Europe were liquidated in New York.

The vast extension of bond buying in the United States in the years which followed the Armistice, however, tended to create more and more difficulty and delay in sending bonds from distant centers to New York for immediate delivery on Stock Exchange "regular way" contracts. With stocks the problem did not exist to the same extent, since the New York broker could often sell the given shares short, borrow them for delivery the next day, and when the certificates arrived in New York deliver them to the lender of the shares; because of

their less active market, bonds could not ordinarily be borrowed in this way, and consequently they usually could not be sold short for "regular way" delivery on the next full business day.<sup>9</sup>

Accordingly, in 1923 the Exchange inaugurated a plan for the delayed delivery of bonds. It was arranged<sup>10</sup> that in the bond market, "regular way" dealings should still provide for the delivery of bonds upon the full business day following the day of contract, except when the seller states at the time of closing the transaction on the floor of the Exchange that his bonds are sold for delayed delivery; in this latter case, the delivery should be made upon the seventh day following the day of contract, but may be made on any full business day prior thereto, upon one day's written notice being given by the seller of his intention to do so. This plan has provided a much-needed flexibility to the Stock Exchange bond market, and is frequently utilized each day.

**Economic Functions of the Bond Market.**—It has already been pointed out that the bond department of the Stock Exchange is not a primary market to the same extent as is the market on the Exchange for shares. From a functional standpoint, therefore, the Stock Exchange bond market must be considered not only as a primary market—which it occasionally is—but also as a public market, dependent upon the outside private market and sharing with the latter its actual economic functions.

When heavy liquidation or other causes of strain in the bond business arise, or when economic circumstances impart an unusual speculative quality to all bonds, the outside or "over-the-counter" bond market tends to dry up, and bond dealings tend to concentrate in the Exchange bond department as a primary market. At such times the economic functions of the Exchange bond market are generally similar to those consistently exercised by the share market on the Exchange; these

<sup>9</sup> See Annual Report of the President, 1923-24, pp. 26-28.

<sup>10</sup> See Appendix Xa.

general functions have already been reviewed in an earlier chapter<sup>11</sup> and need not be repeated here.

But normally the Stock Exchange bond market is merely the public and retail portion of the whole bond market in New York, and thus in fact exercises more specialized economic functions which often relate intimately to the work of the outside bond market.

Perhaps the chief function of the Stock Exchange bond market consists in giving speedy and accurate publicity to bond transactions. No such publicity is available for transactions in the essentially private "over-the-counter" market. Without the Stock Exchange bond market, there would be no available index as to the course either of prices for many individual bond issues, or for bond prices as a whole. Dealers in the outside market not only watch closely Stock Exchange bond prices on the bond tape and in the newspapers, but also frequently send into it through Exchange members requests for quotations. Many Exchange firms in the investment business maintain close connections with institutional and individual bond buyers, as well as with security dealers generally. Knowing the particular wants and interests of each, the investment broker constantly communicates to them bids and offers on the Stock Exchange, and thus greatly facilitates the ability of sellers to sell and buyers to buy on the Exchange bond market. By its broadcasting not only of bond prices but also of bids and offers for bonds, the bond ticker extends the scope of the New York bond market and attracts purchases and sales into it.

This quotation service maintained by the Stock Exchange bond market bears a significant relation not only to the outside bond market in old issues, but even to the market in new issues direct between issue houses and the public. Often new bond issues are listed on the Board before the syndicate agreements as to their distribution have terminated, and sometimes before

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<sup>11</sup> See Chapter II.

the definitive bond certificates are as yet printed. In the latter case, trading in the Exchange bond market may be conducted by contracts calling for the ultimate delivery of the bonds "when, as, and if issued." Thus a chance is given for public opinion to express itself as to the price of the new issue, and according to circumstances the Stock Exchange quotation may rise above or fall below the price at which the new issue was offered to the public.<sup>12</sup>

The Stock Exchange bond market, by reason of its superior organization, also acts as a "shock-absorber" to the rest of the New York bond market, not only when all, but also when individual, bond issues become unusually speculative. Sometimes single bond issues will suddenly acquire hazardous and uncertain qualities, and their primary market will speedily shift from the outside market to the Stock Exchange market.

Finally, the Stock Exchange bond market offers generally unequaled facilities to the small, average individual investor. Due to these facilities, he can review the field of bond investment intelligently, select the bonds best suited to his investment needs, and purchase them through a Stock Exchange firm under standardized regulations especially designed to protect him. While the small investor may and often does purchase bonds direct from non-Exchange member dealers, he must select his seller with much more discretion, since he is not protected by the intermediary Exchange bond broker. Both the organized character of the Stock Exchange bond market and the bond ticker service which it maintains, give him superior assurance as to the fairness of the prices of his purchases or sales. So small are the Exchange bond commission rates that endeavors to "save" them by dealing direct rather than through a broker are apt to prove costly in the end to the inexperienced bond investor.

The ever-present risks and lightning changes of the stock market, its thrills of optimism, and its fits of utter dejection,

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<sup>12</sup> See Chapter IV, p. 91.

penetrate the bond crowd only slowly and temperately. The bond market in the New York Stock Exchange will always prove less animated and picturesque than the larger adjoining market for shares. Nevertheless, the Stock Exchange bond market is also a very vital factor in the general machinery of American finance, and a necessary and integral part of the great market for American securities maintained by the New York Stock Exchange.



## CHAPTER XI

### THE SECURITY COLLATERAL LOAN MARKET

Members and member firms of the Stock Exchange play a major part in the security collateral loan market, usually as borrowers but sometimes also as lenders. The New York Stock Exchange itself, however, never borrows or lends such funds, and therefore is only indirectly concerned with the problems arising from the security collateral loan market. Nevertheless, the Stock Exchange Constitution<sup>1</sup> contains specific regulations in regard to the lending or borrowing activities of its members, and provides central facilities on its floor for them. To students of the Stock Exchange, therefore, the subject of security collateral loans is of inevitable interest.

**Evolution of the Market.**—The security collateral loan market in New York cannot be understood without reference to its long and peculiar evolution. As the most highly organized section of the New York money market, it has been developed far beyond any security loan market abroad. The close proximity and economic interdependence of the European nations from early times forced a development of foreign trade, and the employment of bankers' bills by which such trade can best be financed. Thus the money markets of London and to a lesser extent of other European centers also, came to be based essentially upon their bill transactions and bill markets.<sup>2</sup>

The economic development of the United States has been on quite different lines, and has compelled a very different evolution in the New York money market. Early in the nineteenth century, when our lack of manufacturing facilities made

<sup>1</sup> See Constitution, pp. 38, 73, 87, 88, 92-94, 99, and 118.

<sup>2</sup> Appendix XIa.

us dependent upon foreign imports and our lack of home consumptive power upon exports abroad, bill transactions occurred in the New York market. But as soon as our railways crossed the Alleghanies into the great Mississippi valley, America faced westward and began the tremendous economic conquest of its vast interior regions. This new effort naturally brought about an ever-increasing succession of new security flotations to build railways, open mines, and develop industries, and a decreasing dependence upon foreign trade. In the New York money market, these basic economic factors produced a keen need for constant security loans as an inevitable facility for floating new capital issues, while the business in bills there practically vanished. For many decades thereafter, London regularly financed our foreign trade through its broad bill or discount market, and generally at rates of interest lower than the return on domestic investments which American capital could and did obtain.

Thus by 1850 American bankers were compelled to seek in the New York security collateral loan market that safe, liquid, and flexible outlet for their funds, and that centralization of money rates, which abroad was mainly provided by the bill markets. Owing essentially to this need of the lenders, the New York Stock Exchange adopted a cash instead of a term or future settlement system, and security distribution came to be financed principally by "call" or demand loans. In 1836 Congress refused to recharter the second United States Bank, and for many decades thereafter America suffered under the worst banking system existing in any great country of the world. The lawless epoch of state banking was succeeded by our inflexible and decentralized national bank system. Meanwhile, as a natural effect of the irrepressible banking and economic needs of the country, the New York "call loan" market in securities was privately and extensively organized. With improved means of communication, out-of-town banks became accustomed to send balances to their New York banking correspondents to lend "on the Stock Exchange." Such demand

loans on securities came to constitute centralized reserves which, next after till money, were depended upon by banks everywhere to maintain their liquidity and solvency.

To condemn either the Stock Exchange or security loans for the lapses and defects of this system, seems thoroughly beside the point. No other stock exchange in history ever had such a responsibility for bank liquidity thrust upon it. Certainly the New York Stock Exchange never sought and did not relish a banking system which constantly imposed instability and artificially violent price movements in the securities market. In the defective condition of American banking, "call loans" were not a cause, but actually a partially effective remedy. At least, the development of the call loan market in New York was a natural and constructive evolution, even if burdened with improper banking functions; in addition to constituting the only existing mechanism for centralizing interest rates and surplus bank reserves, it performed spasmodically yet very extensively a vital work in facilitating the flotation of the great amounts of new American securities which the building up of our vast continental areas continually required. It is one of the ironies of American history that the New York stock market was rarely thanked for its long and valiant services in behalf of American banking and industry, and continually assailed for the recurring financial crises imposed upon it by the unwisdom and inertia of American banking legislation.

**The Federal Reserve System.**—The financial crisis of 1907 at length compelled legislative consideration of a better banking and currency system. In 1913 the Federal Reserve Act was passed and the establishment of the new central banking mechanism for which it provided, began. Unlike the Bank of England, which had experienced a slow and mainly empirical growth since 1694, the Reserve system thus sprang full-armed from the foreheads of our legislators, and factors of a temporary and purely theoretical nature inevitably played an important part in its formulation. The new Reserve banks,

for example, were forbidden by the Act to rediscount loans on any security collateral except U. S. Government issues. Thus the central bank system of a country which by virtue of its economic character requires and enjoys the most widespread security business in the world, is forbidden to rediscount a type of loan eligible for the Bank of England and other central banks in countries whose financial needs are to a greater extent mercantile.<sup>3</sup>

That this discrimination against rediscounting security collateral loans has been artificial and legislative rather than founded on sound economic reasons, has been demonstrated by the fact that security loans have steadily increased, and have been depended upon to afford flexibility and liquidity to the whole New York money market. The attempt by statute-making to deny or ignore essential economic fact has thus resulted in artificially separating the security collateral loan market from the other parts of the New York money market, in respect to its interest rates and to some extent its conditions of supply and demand.<sup>4</sup>

**War Time Regulation of Security Loans.**—After America entered the Great War, it became imperative to divert as much as possible of our capital into the flotation of our vast new Liberty Loans. Yet it was found necessary to issue U. S. Government bonds faster than they could be taken up outright by available capital or private savings. Therefore, the Government urged the public to buy them on credit or "margin," and this naturally led to vast increases in loans on security collateral. Lest the general investment market should compete with the State for available American capital and credit, an appeal was made by the "Money Committee" in New York to the Stock Exchange, and the latter undertook to limit increased borrowing in securities by its members.<sup>5</sup> At the same time the leading New York banks provided a pool of funds to carry

<sup>3</sup> See Appendix XIb.

<sup>4</sup> See Sen. Doc. 262, p. 9.

<sup>5</sup> See Appendix XIc.

on the minimum requirements of the security market. This arrangement continued until 1919.

Out of this period of war regulation, however, came two permanent improvements in the security loan market. Previously, call money had been bid for like shares at a certain post on the Stock Exchange floor.<sup>6</sup> But more effectually to regulate and stabilize the market, the money desk system, presently to be described, was installed.<sup>7</sup> Also, the Federal Reserve Bank of New York began in 1917 to compile statistics as to the funds loaned on security collateral by its member banks, and in 1918 the New York Stock Exchange began a similar compilation of the borrowings on securities made by its members. The Reserve Bank has continued its compilation ever since, while the Exchange discontinued its figures at the end of 1922, but began them again at the beginning of 1926 on a monthly basis. On the latter occasion, the Reserve system and the Exchange simultaneously adopted the policy of publishing these figures regularly.<sup>8</sup> In this way an increasing knowledge of the security loan market and a reasonably precise measure of its outstanding amounts, is regularly made available to everyone.

**The Time Loan.**—There are two distinct types of loans made upon security collateral—time and call loans. The time loan, as its name implies, is made for a definite period of time—three, six, nine, or sometimes twelve months—at a fixed rate of interest which does not change during the life of the loan. To secure the loans there are deposited as collateral with the lender, securities whose value exceeds the amount of the loan by a minimum of 20% to 30%. The lender is also protected by the agreement (Figure 20) that if the market price of the security collateral declines, the borrower must put up additional securities as collateral. For if during a falling market

<sup>6</sup> For details of the prewar methods of lending money on the Stock Exchange floor, see testimony of J. H. Griesel, Money Trust Investigation, Vol. I., p. 742 *et seq.*, and also Appendix XIId.

<sup>7</sup> See testimony of Governor Strong, "Stabilization" hearings, p. 353 *et seq.*

<sup>8</sup> *Ibid.*, p. 360 *et seq.*; also testimony of Governor Roy Young in La Follette Resolution hearings, p. 68.



\$100,000<sup>00</sup>/<sub>X</sub> NEW YORK, May 8 1929

Jenkins & Co. for value received

the undersigned promise to pay to The Blank Trust Co.

on order, at the banking office of The Blank Trust Co. New York on August 8, 1929

One hundred thousand dollars, with interest

from date until payment hereof at the rate of 6 per cent. per annum

having assigned and transferred, and hereby assigning and transferring, to the holder hereof for the time being, as collateral security for payment hereof,—as well as for the payment of any and every debt or liability of every name and nature, whenever contracted and whenever due, from the undersigned to such holder hereof existing while such holder,—the following property, hereby and herewith pledged and delivered to such holder for the time being as collateral security for this and for every other such indebtedness, viz:

|                                  |              |                  |
|----------------------------------|--------------|------------------|
| <u>300 General Motors</u>        | <u>@ 75</u>  | <u>22,500.00</u> |
| <u>100 Packard T. &amp; S.F.</u> | <u>@ 212</u> | <u>21,200.00</u> |
| <u>500 Pennsylvania</u>          | <u>@ 77</u>  | <u>38,500.00</u> |
| <u>200 Baltimore &amp; Ohio</u>  | <u>@ 124</u> | <u>24,800.00</u> |
| <u>200 Consolidated Gas</u>      | <u>@ 113</u> | <u>22,600.00</u> |

of which the present market value is now estimated by the undersigned to be \$129,600 and also, any and all property, claims and demands of every name or nature belonging to the undersigned and either directly or indirectly or for any purpose in possession or under control of such Holder hereof, while such holder, including a lien upon any balance of any deposit account of the undersigned with such holder hereof, while such holder; and the undersigned hereby agrees from time to time, and at any time, similarly and forthwith upon demand therefor by any such holder, to pledge and to deliver hereunder any and all such additions or substitutions of collateral security as may be indicated in a notice addressed to the undersigned and left at 500 Wall St., New York City

On the non-performance of this promise, in whole or in part, or upon the non-payment of any liability above mentioned, or upon failure to furnish other satisfactory securities, as and when so called for, then, and in every such case, at the option of such holder, this note forthwith shall become and shall be due and payable, without other demand or notice, and full power and authority are hereby given to such holder to demand payment of and to collect any promises to pay forming part of the said securities, and also full power and authority to sell, assign and deliver the whole of the said securities, or any part thereof, or any substitutes therefor, or any additions thereto, or any other securities or property either directly or indirectly given to or left in the possession of such holder by the undersigned, at any Brokers' Board or at public or private sale, at the option of such holder, without either demand, advertisement or notice of any kind, all of which are hereby expressly waived. At any such sale at any Brokers' Board, or at any public sale, such holder, on his or its own account, and without further accountability except for the purchase price thereof, may purchase the whole or any part of the property sold, free from any right of redemption on the part of the undersigned, which right is hereby waived and released. In case of sale for any cause, after deducting all costs or expenses of every kind for collection, sale or delivery, the holder for the time being, without any marshalling of securities, and in such manner or order as he or it may deem proper, may apply the residue of the proceeds of the sale or sales so made, in payment or in reduction of any one or more of such liabilities to such holder then unpaid, whether then due or not due, making proper rebate for interest on liabilities not then due, and returning the overplus, if any, to the undersigned who, notwithstanding any transfer, shall continue liable to the holder hereof for the time being for any deficiency arising upon such sale or sales.

Jenkins & Co.

Figure 20. Time Loan Agreement

the borrower allows the value of his collateral securing a time loan to decline below the margin agreed upon, then by the terms of the time loan agreement the loan immediately becomes due, irrespective of its maturity date, and the lender can at once demand payment. This being refused, he can at once sell the collateral securities to recover the principal and interest of his loan. In practice the borrower always hastens to put up more collateral on his time loans, whenever such a course is necessary.

Generally speaking, the interest rate for time money relates to the prevailing and anticipated movement in the rates for call loans. The proportion of time and call loans in total security loans varies from time to time according to conditions, but the call money always constitutes the larger part, owing primarily to its greater popularity with lenders. For the same reason, it is normal for call interest rates to rule slightly lower than time loan rates. Time funds have constituted more than 40% and as little as 10% of all outstanding security loans.

**The Call or Demand Loan.**—As its name implies, the call or demand loan can be “called” or terminated on the demand of either the borrower or the lender, the day after it is made. Legally, indeed, the call loan can be terminated at any time, but the unwritten custom of Wall Street forbids the calling of loans after noon, and thus they constitute at least overnight funds. Only a small proportion of call loans, however, is actually called each day; the bulk of such loans outstanding are renewed daily, frequently at varying interest rates. Some call loans have actually been outstanding for fifteen or twenty years, but such cases are of course exceptional. Due to the high degree of market organization, the calling of loans involves no personal feeling on the part of either borrower or lender.

**The Demand for Security Collateral Loans.**—Loans are often made on security collateral by American banks entirely outside of Wall Street, either to facilitate investing or trading

in securities, or to make commercial loans to borrowers whose credit would not justify unsecured banking advances.

In the New York financial center, however, security loans are made almost entirely for financial reasons, such as carrying customers' margin purchases for a broker,<sup>9</sup> or undistributed new securities for a dealer.<sup>10</sup> Since firms which are members of the New York Stock Exchange may also be members of the New York Curb Market or of out-of-town stock exchanges, may participate in new security underwritings and flotations and may also operate extensive "unlisted departments" dealing in securities whose only market is "over-the-counter," the security loans contracted by Stock Exchange houses may occasionally contain in their collateral, issues listed on many different stock exchanges and sometimes on no stock exchange at all. In the aggregate, security collateral carried in this way in Wall Street constitutes the dealers' floating or market supply of securities, or the amount which investors have not as yet purchased.

We have seen<sup>11</sup> that a broker who purchased 100 shares of Steel at 150 for his customer on a 50-point margin, has to pay off the seller in full the next day, and therefore has to obtain promptly the \$10,000 which the customer owes on the security. This he does as a rule by placing the certificate in a collateral loan, and if necessary financing himself on unsecured "day loans" until the proceeds of the secured loan become available.<sup>12</sup>

As a rule, it is between 10 A.M. and 2:30 P.M. that Stock Exchange firms telephone their floor members to obtain collateral loans to carry the aggregate amount of the day's transactions, or on account of loans previously made but then called or paid off, or for other purposes. The floor member who receives such a message goes to the "money desk" on the floor and thus gets in contact with the available lenders.

<sup>9</sup> See Chapter VII, p. 182.

<sup>10</sup> See Chapter IV, p. 91.

<sup>11</sup> Chapter VII, p. 182.

<sup>12</sup> Chapter XII, p. 343.

**The Supply of Call Money.**—The security loan market in New York can and does attract funds from all over the United States, and even from foreign countries. The Federal Reserve statistics on stock market loans are for convenience divided into three main classes, according to the three chief sources of the funds: (1) loans for the account of New York banks and trust companies; (2) loans for the account of out-of-town American correspondent banking institutions; and (3) loans for the account of "other lenders"—principally foreign banks, private individuals, and domestic business corporations. Neither the Reserve nor the Stock Exchange statistics as to security loans in New York are necessarily all-inclusive, since Reserve figures do not, of course, include loans made by non-members of the Federal Reserve system, while the Stock Exchange compilation does not include borrowings by non-members of the New York Stock Exchange. If a non-member of the Reserve system should lend to a non-member of the New York Stock Exchange, the loan would not be reported in either compilation. In the Stock Exchange statistics, borrowings are divided into two main classes: (1) those from New York banks and trust companies—which group corresponds fairly closely with the total Federal Reserve figures; and (2) those from "private bankers, brokers, foreign bank agencies or others in the City of New York"—which are not of course included in the Reserve compilation at all.

When funds of out-of-town banks or "other lenders" are remitted to New York banks and trust companies to be loaned in the stock market, the New York institutions may act either as depository and principal, or as agent. In the former case, the New York institution really borrows the funds itself, pays a rate of interest upon them to the original lender, and relends them in such ways and at such rates as it sees fit. In the latter case, the New York institution is an agent only, and obtains a commission from the original lender. In either case, the New York institution assumes responsibility for making the loan, and supervising its collateral while it is outstanding. Some-

times there may be intermediaries between the original lender and the New York institution; interior banks, for instance, instead of sending their funds direct to New York banks, may turn them over to large nearby banks in Chicago, Boston, Cleveland, Detroit, and other centers, and these institutions may in turn send them to New York to be invested in the security loan market.

Bankers, whether in New York or not, will necessarily prefer to make commercial loans to their regular clients and depositors, rather than to make largely impersonal security loans. This is due to the fact that to survive and grow in competition, banks must build up their deposits, which commercial lending facilitates much more than do stock market loans. As a result, it is only the excess funds of banks, over and above what they can safely lend to commercial customers, that are loaned on security loans.<sup>13</sup> Usually the rate on the latter is lower than those for local commercial loans and advances. But the banker must in the interests of self-preservation, keep some of the funds entrusted to his care in speedily recoverable form, and for this purpose the proven safety, liquidity, and availability of security call loans have commended them to him for many years. Due to the highly organized security loan market in New York, lenders everywhere can secure safety and liquidity in the investment of their short-term funds, and thus avoid the waste incident upon idle funds and the losses arising from improperly secured and illiquid placements of funds. On the other hand, this vast mobilization of surplus funds in New York makes it possible for the financial center there to provide a broad and continuous capital market for the whole country, and to enable the wholesale flow of money into productive facilities for industry and trade.

**The New York Security Loan Market.**—Security collateral loans can be and are negotiated in New York in three different ways: (1) by direct dealings between borrower and lender; (2) through professional money-brokers; and (3)

<sup>13</sup> See Appendix XIc.



through the "money desk" system on the floor of the New York Stock Exchange. Both borrowers and lenders use whichever of these methods is most advantageous in the given case. The personal element in such loans is an important factor in the first case, less important in the second, and mainly inconsequential in the third. Also, the rates and conditions of loans made by the first method are private and usually undisclosed, in the second mainly so, and in the third a matter of common public knowledge. Usually interest rates are about the same in all cases, but when a considerable difference in rates develops between them, funds tend to flow into the most profitable section of the market and borrowers flock to the cheapest section of it, with the result of speedily effecting an equalization in rates between them again.

Time loans are never made through the "money desk" on the Exchange, but are made either directly between borrowers and lenders, or through a money-broker who charges the borrower on the average  $1/32\%$  of the principal of the loan for his services in obtaining the funds. On the other hand, a large proportion of new call loans are made through the "money desk," and a very large proportion of all outstanding call loans are renewed each day at the renewal rate posted there.

In order to diversify its risks, the New York lending institution naturally prefers to lend its funds to many rather than to only a few security dealers and brokers. Similarly, a borrower on security collateral usually prefers to obtain his funds from several different lenders, in order to diversify the risk of having an inconvenient amount of his loans called at one time. The market has therefore developed the standard unit of \$100,000 for security loans, although such loans in multiples of \$100,000 and also for lesser amounts than \$100,000 are frequently made.

**Changeability of Supply and Demand.**—The extreme liquidity of the call loan market<sup>14</sup> permits of swift changes in

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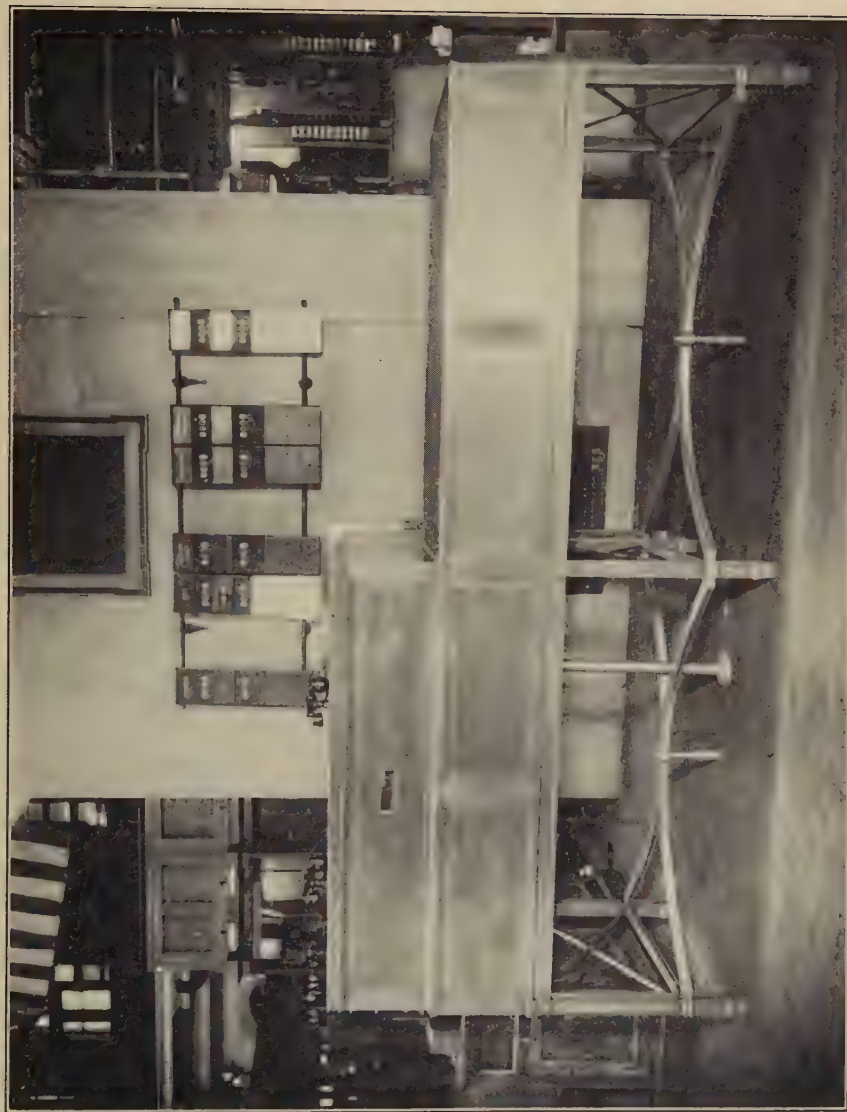
<sup>14</sup> See Appendix XIc.

the supply of and demand for call funds each day. From the banking standpoint, funds in the call loan market are excess or surplus funds, which may be withdrawn at any time for increased commercial needs, or added to because of inadequate commercial demand. Moreover the stock market, whose distributory processes call loans facilitate, is itself a surplus market, highly sensitive to the relative amounts of capital available for security investment. Specifically, call loan interest rates may be considerably affected by temporary shifts in the money market arising from lowered bank ratios, Federal Reserve rediscounts and open market operations, withdrawal of government funds, Treasury financing, maturity or interest dates of outstanding security issues, etc. New York State usury laws legalize any rate of interest on call loans of \$5,000 or over, secured by collateral.<sup>15</sup> American geography also plays its part in rendering the supply of and demand for call funds changeable. Since in point of time Chicago and New Orleans are one hour, Denver and Omaha two hours, and San Francisco three hours behind New York, it sometimes happens that late in the day funds may suddenly pour into the New York call loan market or be suddenly withdrawn from it, from causes arising in distant parts of the country. As a result, call loan interest rates are subject to swift changes, which are as a rule self-corrective. The increased stability imparted to the whole New York money market by the Federal Reserve system has had the general effect of rendering security loan rates much more stable than they were prior to its establishment.<sup>16</sup>

**The "Money Desk."**—The "money desk," where the open supply of and demand for call funds meet, is located on the Stock Exchange floor, between the old Board room and the Wall Street extension (Plate 9). Nearby are posted the current and renewal money rates for the day. A clerk records the demand for and offers of call funds as they come to the desk, and puts prospective borrowers and lenders together on the basis of "first come, first served." In this way, there is main-

<sup>15</sup> See Appendix XIg.

<sup>16</sup> See Appendix XIh.



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Plate 9. The Money Desk



tained the freest, most highly organized, most accessible, and most public security loan market in the world. Moreover, few if any money markets anywhere are to the same extent as completely subject to the natural forces of supply and demand.<sup>17</sup>

When an Exchange firm discovers that additional borrowings on collateral will be needed to carry its engagements, it usually telephones its floor member on the Exchange; the latter gets the request at his telephone, and goes to the money desk with it to discover a lender.

New York bankers usually wait each morning until about 11:30, when their returns from the Bank Clearing House are received; they then know their exact financial position, and therefore whether they should make fresh call loans or withdraw funds already in them. Later in the day, due to the shifting of accounts of local or out-of-town depositors, the bank's position may be changed, and the amount of its funds available for call loans either increased or decreased. Thus a given lending institution may make new loans early in the day only to withdraw funds from the market later, or call its loans early and make new loans afterwards. In calling a loan, the banker telephones the borrower direct. But in making new loans at the money desk, the incorporated bank cannot go upon the Stock Exchange floor itself (not having a Stock Exchange membership<sup>18</sup>) to discover who wishes to borrow. For this reason the banker usually telephones to the office of some Stock Exchange firm and requests it to do so for him. Exchange firms are always willing to perform this service to lenders without fee or charge. The Exchange firm then telephones to its floor member on the Exchange, who next proceeds to the money desk with the bank's offer to lend money, and enters the offering with the clerk at the desk.

Thus, much the same machinery is used in borrowing or lending money on the Exchange, as for purchasing or selling

<sup>17</sup> See Appendix XIa.

<sup>18</sup> See Chapter XVI, p. 443.



securities. Like orders to buy or sell, offers to lend or borrow money may be "limited" at some fixed figure—say 4%, or may like a "market order" be without such limitation. The clerk at the money desk neither lends nor borrows money himself, nor settles details concerning the nature or amount of the security collateral. He simply puts borrowers and lenders in touch with each other, and then withdraws from the operation entirely, leaving such details for them to settle. As compared with the old system of bidding for money at the "money post," the operation of the money desk system has undoubtedly served to stabilize the call loan market.

**Loan Agreements.**—As has been seen, specific agreements are sometimes entered into between borrower and lender as to the terms of time loans. Call loans change too rapidly to permit such a practice in their case, and thus general or "blanket" agreements between borrowers and lenders are usually employed. When a new Stock Exchange house is organized, usually it files such an agreement with the chief lending institutions in Wall Street, concerning call loans which in the future may be made between them. The call loan market in New York is, however, so old and so thoroughly organized, that its operations can be and are carried on by common custom; for this reason, these loan agreements (see Figure 21) are for the most part a formality and a precaution rather than a practical factor in the market.

Thus in practice the Exchange member who has loaned funds for a bank at the desk, simply informs the lender as to whom the loan was made, and then steps out of the transaction completely. Similarly, the Exchange member on the floor who has borrowed funds for it, informs his firm. It then remains for the borrowing office to deliver the security collateral involved to the lender, and to obtain the lender's funds.

**Settlement of Loan Contracts.**—Thus far only the contracts for lending call money on the Exchange have been de-

scribed. We must now see how such contracts are carried out. The payment of the loaned funds by the lender may or may not be made through the Stock Clearing Corporation by specific methods presently to be described.<sup>19</sup> A more complicated task is the preparation of the security collateral by the borrower and its submission to the lender.

|                                                                                                                                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
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| <div style="border: 1px solid black; width: 60px; height: 40px; margin: 0 auto; display: flex; align-items: center; justify-content: center;">             STAMP.           </div> | <p><b>Know all Men by these Presents.</b> That the undersigned, in consideration of financial accommodations given, or to be given, or continued to the undersigned by The Blank Trust Co. of the City of New York hereby agree with the said firm that whenever the undersigned shall become or remain, directly or indirectly, indebted to the said firm for money lent, or for money paid for the use or account of the undersigned, or for any overdraft or upon any endorsement, draft, guarantee or in any other manner whatsoever, or upon any other claim, the said firm shall then and thereafter have the following rights, in addition to those created by the circumstances from which such indebtedness may arise against the undersigned, or his or their executors, administrators or assigns, namely:</p> <p>1. All securities deposited by the undersigned with said firm, as collateral to any such loan or indebtedness of the undersigned to said firm, shall also be held by said firm as security for any other liability of the undersigned to said firm, whether then existing or thereafter contracted; and said firm shall also have a lien upon any balance of the deposit account of the undersigned with said firm existing from time to time, and upon all property of the undersigned of every description left with said firm for safe keeping or otherwise, or coming to the hands of said firm in any way, as security for any liability of the undersigned to said firm, now existing or hereafter contracted.</p> <p>2. Said firm shall at all times have the right to require from the undersigned that there shall be lodged with said firm as security for all existing liabilities of the undersigned to said firm approved collateral securities to an amount satisfactory to said firm; and upon the failure of the undersigned at all times to keep a margin of securities with said firm for such liabilities of the undersigned, satisfactory to said firm, or upon any failure in business or making of an insolvent assignment by the undersigned, then and in either event all liabilities of the undersigned to said firm shall at the option of said firm become immediately due and payable, notwithstanding any credit or time allowed to the undersigned by any instrument evidencing any of the said liabilities.</p> <p>3. Upon failure of the undersigned either to pay any indebtedness to said firm, when becoming or made due, or to keep up the margin of collateral securities above provided for, then, and in either event, said firm may immediately, without advertisement and without notice to the undersigned, sell any of the securities held by it as against any or all of the liabilities of the undersigned, at private sale or Brokers' Board or otherwise, and apply the proceeds of such sale, as far as needed, toward the payment of any or all of such liabilities, together with interest and expenses of sale, holding the undersigned responsible for any deficiency remaining unpaid after such application. If any such sale be at Brokers' Board or at public auction said firm may itself be a purchaser at such sale free from any right or equity of redemption of the undersigned, such right and equity being hereby expressly waived and released. Upon default as aforesaid said firm may also apply, toward the payment of the said liabilities, all balances of any deposit account of the undersigned with said firm then existing.</p> <p>It is further agreed that these presents constitute a continuing agreement, applying to any and all future, as well as to existing, transactions between the undersigned and said firm.</p> <p style="text-align: right; margin-right: 100px;"> <i>Jenkins &amp; Co.</i><br/>       _____     </p> <p>Dated New York, the <u>23</u> day of <u>April</u>, 192<u>7</u></p> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Figure 21. General or "Blanket" Loan Agreement  
Employed to cover call loans.

Except with loans on bond collateral (which being in \$1,000 pieces, is apt to prove too bulky) security collateral is placed in a large paper envelope (Figure 22). Securities used as collateral in this way belong to the Stock Exchange firm itself, or to its customers who have purchased them on margin. In the latter case, the customer has already agreed to their hypothecation according to the rules of the Stock Exchange.<sup>20</sup> The outside face of the loan envelope contains the name of the borrower and the lender, the date, the principal

<sup>19</sup> See Chapter XIV, p. 374.

<sup>20</sup> See Appendix XII.

amount of the loan, its interest rate, and an itemized list of its security collateral. This list states the name of the securities, the number of shares, the price per share, and the value at

| No. <u>234</u><br><i>Fiftieth National Bank</i><br><b>DEMAND LOAN</b><br><b>JENKINS &amp; CO.</b><br>\$ <u>100,000.<sup>00</sup></u><br>Date <u>August 16, 1929</u> Rate <u>6%</u> |                                |       |        |     |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------|--------|-----|
| Shares                                                                                                                                                                             | SECURITIES                     | Price | Amount |     |
| 200                                                                                                                                                                                | <i>Southern Pacific</i>        | 130   | 26     | 000 |
| 100                                                                                                                                                                                | <i>Canadian Pacific</i>        | 222   | 22     | 200 |
| 100                                                                                                                                                                                | <i>U. S. Steel</i>             | 150   | 15     | 000 |
| 500                                                                                                                                                                                | <i>U. S. Rubber</i>            | 50    | 25     | 000 |
| 500                                                                                                                                                                                | <i>American Sugar Refining</i> | 76    | 38     | 000 |
| 1400                                                                                                                                                                               |                                |       | 126    | 200 |
|                                                                                                                                                                                    |                                |       |        |     |

Figure 22. Face of Call Loan Envelope.

Recording a loan of \$100,000 by the Fiftieth National Bank to Jenkins & Co. on \$126,200 of collateral.

these prices in even figures. Since call loans, as already stated, are made under general agreements between borrower and lender, the only specific loan contract with a single call loan

consists in the face of the envelope itself, made out as above described.

**Diversification of Security Collateral.**—One reason for the essential safety of security loans consists in the care exercised in diversifying their collateral. Each loan is thus a sort of miniature investment trust. The high degree of organization in the security loan market has developed an extensive technical practice in this respect.

Years ago, American railway shares constituted a larger proportion of Stock Exchange turnover and listings than to-day, and were in addition more stable as a rule than American industrial shares. In consequence, many "all-rail" loans used to be made, as follows:

#### ALL-RAIL LOAN OF \$100,000

Based entirely on railroad stocks. Margin about 29%.

|                                         |                 |
|-----------------------------------------|-----------------|
| 200 Delaware & Hudson R. R. at 190..... | \$ 38,000       |
| 100 New York Central R. R. at 193.....  | 19,300          |
| 300 Erie R. R. at 78.....               | 23,400          |
| 200 Northern Pacific R. R. at 103.....  | 20,600          |
| 200 Illinois Central R. R. at 138.....  | 27,600          |
| <hr/> 1,000                             | <hr/> \$128,900 |

As industrial issues assumed increasing importance and stability in the market, they came to be included in loan collateral. Thus additional diversification was provided. In fact, before the war, the favorite selection of such collateral consisted of two-thirds rails and one-third industrials, and was known as the "regular" loan on "mixed" collateral.

#### OLD REGULAR LOAN OF \$100,000

Based on mixed collateral,  $\frac{2}{3}$  rails and  $\frac{1}{3}$  industrials. Margin about 31%

|                                          |                 |
|------------------------------------------|-----------------|
| 200 Southern Railway at 138.....         | \$ 27,400       |
| 300 Pennsylvania R. R. at 77.....        | 23,100          |
| 300 Baltimore & Ohio R. R. at 124.....   | 37,200          |
| 200 Consolidated Gas at 113.....         | 22,600          |
| 200 American & Foreign Power at 104..... | 20,800          |
| <hr/> 1,200                              | <hr/> \$131,100 |

The war period of 1917-19, which changed so many financial customs and practices everywhere, made its peculiar exigencies felt inside Wall Street security loan envelopes. While during these years the railroad business was hazardous and unprofitable, the enormous production inaugurated by the war imparted great strength to many industrial shares. Thus the "regular loan" came during this period to consist of rail and industrial shares in about equal proportions. Likewise, the rise of industrial shares in comparative merit and activity gave rise to more "all-industrial" loans, previously thought a rather hazardous type.

#### ALL-INDUSTRIAL LOAN OF \$100,000

Based entirely on industrial stocks. Margin 30%

|                                                |                 |
|------------------------------------------------|-----------------|
| 300 General Motors at 72.....                  | \$ 21,600       |
| 300 Pan American Petroleum at 59.....          | 17,700          |
| 300 Liggett & Meyers at 85.....                | 25,500          |
| 200 Crucible Steel at 92.....                  | 18,400          |
| 100 Sears-Roebuck at 155.....                  | 15,500          |
| 100 American Telephone & Telegraph at 207..... | 20,700          |
| 100 Anaconda Copper at 106.....                | 10,600          |
| <hr/> 1,400                                    | <hr/> \$130,000 |

Since the war, the "all-rail" loan has become very rare, and the "all-industrial" loan the commonest of all types. It is also true that in many loans, bonds are introduced, and some loans are made entirely on bond collateral.

To the lender on securities, the quality and price-stability of the collateral are naturally important, and he may refuse to accept issues which he considers weak or overpriced, either altogether or unless unusually heavy margins are provided. But both by demanding high margins and by pricing collateral below market prices to suit himself, the lender can in practice protect himself very completely even when lending upon thoroughly speculative securities whose price fluctuations may be great. Therefore to the lender marketability is highly essential, since to protect his loan he must be able to sell the collateral speedily. This is the reason why a lender will sometimes



balk at securities of excellent intrinsic value, which cannot readily be sold on the Stock Exchange and will often decline absolutely to lend on them if they are not listed there. He is also wary of stocks with very high prices, or others subject to heavy price fluctuations. He dislikes "odd lots" of from 1 to 99 shares of stock, since these may involve a more complicated process in marketing than "round lots" of 100 shares or multiples of 100 shares.

As security markets became more organized and continuous, the securities dealt in upon them became more and more available for loan collateral, apart entirely from their intrinsic value. This fact not only explains the popularity of collateral which is listed on the New York Stock Exchange, but also the increasing acceptance as collateral of issues listed on other definitely organized and increasingly dependable stock exchanges in this country.

**Protection of Lenders.**—In the example of the \$100,000 loan envelope given in Figure 22, it will be noticed that the loan is secured by an excess of collateral amounting to about 25%. The amount of this security margin over the face of the loan demanded by lenders, varies somewhat from time to time according to conditions in the money market and the stock market, and also according to the quality of collateral, the particular policies of individual lenders and numerous other factors. Often, however, Stock Exchange firms take pride in considerably exceeding the minimum security margin requirements of the lender, and when collateral values shrink through declining security prices, usually provide additional securities to margin their loans before the lenders even request it. As the large lenders all have stock tickers in their loan departments, however, they are always in a position to require more margin the instant they consider it necessary. Also, under their agreements with the borrower, they can "throw out" of the envelopes any collateral they do not like, and require the borrower to make "substitutions" by providing more acceptable securi-

ties. With call loans they can instantly retire the whole loan at will, and with time loans this can be done if the borrower does not in every way satisfy their collateral requirements.

In addition to these extensive powers of self-protection, there is often a second and more or less concealed margin provided on security loans, arising from the fact that the lender can "mark" any collateral security at any price he wishes. If, for example, he considers Steel too high at 160, he may refuse to lend on it above a marked value of 140. This practice is mostly employed after considerable price advances in the market. This was very conspicuously the case in the summer of 1929 before the panic. During the crisis, however, lenders relaxed margin requirements on loans from about 50% to about 25%, which afforded valuable relief to the rapidly declining stock market, and proved the desirability of maintaining flexible margin requirements.

Lenders usually are willing to accommodate borrowers by allowing the latter to get certificates wanted for delivery out of their loan envelopes, provided that they "substitute" other securities equally acceptable. While this practice considerably complicates the work of security lenders' offices, it is necessary in keeping the delivery system of the whole stock market prompt and flexible.

It may be that the plans now contemplated by the Stock Exchange for the central depositing of securities and their handling by security-checks, after the admirable German practice, may ultimately relieve New York banks of their present irksome duties with substitutions, by having these effected in a central security depository.<sup>21</sup>

**Acceptance of Collateral.**—The loan envelope having been prepared in accordance with the verbal understanding concerning the loan made at the money desk, the borrower's messenger takes it to the office of the lender, or may send it thither through the Stock Clearing Corporation. The lending officer

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<sup>21</sup> See Chapter XIII, p. 359.

in charge may find its collateral securities unacceptable for some reason suggested above, in which case the borrower may be forced to make up a new collateral envelope containing more or better securities. But if the collateral at first furnished is satisfactory to the lender, the latter places the envelope in his safe and pays to the borrower the principal of the loan. Lenders' requirements are so well understood by borrowers in Wall Street that ordinarily any exceptional features in respect to collateral are eliminated by the borrower at the outset. Loans possessing such unusual collateral features are usually negotiated direct between lenders and borrowers, instead of through the Stock Exchange money desk, in order to avoid misunderstandings and delays.

**The Termination of Call Loans.**—Call loans may be terminated either by the lender "calling the loan," or the borrower on his own volition "paying it off." If desired, the payment of money and delivery of securities involved in terminating a security loan can be handled through the Stock Clearing Corporation.<sup>22</sup> But if this is not done, and the matter is handled "ex-Clearing House," the borrower must present a certified check for the principal and interest of the loan to the lender, whereupon the latter returns to him his security collateral.

**Renewal of Call Loans.**—On any given day, new call loans made together with old loans called or paid off, constitute only a very small percentage of total call loans outstanding, of which over 95% are in fact simply "renewed" each day. But the interest rate applying to a renewed loan is not necessarily that originally stipulated when the loan was first made, but instead the "renewal rate" for each day that it is thus renewed. Consequently, a call loan may actually remain outstanding for a considerable period, and its interest rate will be marked up or down each day according to the latest renewal rate.

This renewal rate for call loans is not an "official rate," but only an estimate of the fair rate for call money made after

<sup>22</sup> See Chapter XIV, p. 374.

consulting leading and typical lenders, borrowers and money experts. The initiative in establishing the renewal rate is taken by the Executive Committee of the Stock Clearing Corporation; after considering available statistics and circumstances relating to current money-market conditions, and obtaining the views of prominent and representative borrowers and lenders, this Committee fixes the renewal rate. There is usually a considerable body of facts to guide very accurately the establishment of the renewal rate. The condition and rates of the call money market the preceding day, the surplus funds (if any) at its close, and other important factors are taken into careful consideration. The renewal rate is made shortly after 11:30 A.M., posted near the money desk on the Stock Exchange and printed on the tape.

Since the renewal rate is merely an expression of expert opinion, and not in any way binding upon either borrowers or lenders, only to the extent that it is satisfactory to these lenders and borrowers are loans actually renewed. It often happens that a lender will refuse to renew his loans at what may seem to him too low a renewal rate; he will therefore call his loans, and endeavor to put his money out later on at a higher rate. Similarly, borrowers may pay off loans in the belief that they can reborrow later at rates lower than the posted renewal rate. But so delicately and expertly is the suggested rate for renewals made that it is usually recognized as a very accurate indication of the fundamental conditions of supply and demand, and therefore as a satisfactory basis upon which to renew call loans for at least a single day. Statistics<sup>23</sup> show that during the years 1922-29, the average variation between the average of renewal rates and that of new loans made, has amounted to only 0.04 of 1%, and in some years has been as low as 0.005 of 1%. These figures are conclusive proof of the accuracy with which the renewal rate habitually accords with current rates for new loans, which are of course established purely by bartering between lenders and borrowers.

<sup>23</sup> See Appendix XIj.

After the renewal rate has been posted near the money desk, the rate for new call loans may fluctuate upward or downward in accordance with subsequent conditions of supply and demand. Some days no fluctuation at all occurs, while on others the fluctuations may be great. In any case, the first current rate of the day is posted near the money desk beside the renewal rate, and as changes in the former occur, the latest current rate is at once posted. As long as rediscounting of security collateral loans at the Federal Reserve Bank is forbidden, comparatively violent fluctuations in their rates are bound occasionally to recur.

**Are Call Loans Safe?**—It has long been recognized by practical American bankers that call loans on listed security collateral constitute the safest and most available form of short-term loan in this country.<sup>24</sup> For this safety there are many good and sufficient reasons. Their collateral can speedily be sold on the Stock Exchange, and Exchange quotations are speedily made available to lenders by the ticker. The loans bear an ample margin of collateral value in excess of the amount loaned upon them, and sometimes an additional concealed margin in the form of collateral issues marked by the lender below current prices. The lender can demand more or better collateral, re-mark the prices of collateral, or call the whole loan, at once. In addition, call loans are contracted in the name of Stock Exchange firms whose credit, in many cases, would be ample for unsecured banking accommodation. Every such Stock Exchange borrowing firm is subject to the disciplinary rules of the Exchange, which forbid reckless and unsound dealings, to the inspection of its financial condition by the "questionnaire system," and by many effective indirect methods of financial survey. Finally, each Stock Exchange firm must possess at least one Stock Exchange "seat" which is unmortgaged and available for creditors in case of suspension for

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<sup>24</sup> See Appendix XIk.



insolvency. No other loan in this country, and perhaps in any country, has behind it as many protective features as our security call loans.

For many years—even in the panic of 1907—there has never occurred a case when Stock Exchange brokers with good collateral were actually unable to obtain the funds they needed. No brokerage firm in Wall Street with good security collateral has ever failed for lack of banking accommodation. On the other hand, even in the long memory of the oldest lending institutions in Wall Street, there is no record of any unpreventable loss by a lender on call loans made to a Stock Exchange member on listed collateral. This sweeping yet justifiable statement attests the unique safety of properly made and managed call loans to the lenders.

The supreme test of the safety of call loans was witnessed during the 1929 panic, when total borrowings on security collateral by New York Stock Exchange firms declined from \$8,549,383,979 on October 1 to \$4,016,598,769 on December 1—a liquidation of over \$4,500,000,000 in two months—without the loss of a penny to a single lender. Such a liquidation is impossible to parallel in the history of the world's money markets, either in amount or percentages.

The safety of call loans has proved of very great benefit to country bankers particularly, since their business is often subject to wide seasonal fluctuations between a shortage and a surplus of good local investments. Time and again, wisely managed country banks have saved themselves from a wave of local banking insolvency, by investing their funds largely in safe and liquid call loans. The Florida land crash a few years ago is only the most recent of many similar cases of this kind which could be cited. While it is true that call loans might be "frozen" by an enforced closing of the Stock Exchange, this extreme eventuality has occurred only twice since 1817, and from causes which presumably would not cause a similar closing today.

**Are Call Loans Legitimate?**—Occasionally financial writers attempt to draw a distinction between commercial loans and security loans by referring to the former as “legitimate,” with the implication that the latter are really not legitimate, however convenient and safe they may be. Any such distinction is vague and fallacious, for security loans are as legitimate in purpose or function as any other form of loan, although not perhaps quite so essential as commercial loans made actually to transport merchandise from producers to consumers. Security loans result as a rule from speculative operations, just as practically all commercial loans do also, but speculation is not “gambling,”<sup>25</sup> nor is it accurate to term either class “gambling loans,” either on legal or economic grounds. It is a similar confusion of thought that leads occasional persons to declare call loans “inflationary.” No doubt inflation in the stock market is sometimes unconsciously facilitated with the aid of call loans, just as it is in commodities by commercial loans, or in land by mortgage loans. Yet of these three, inflation in the stock market is the least dangerous, as the events of the 1919–21 inflation clearly prove, for the security market is a surplus capital market by nature and is much more easily deflated than either commodities or land. As a matter of fact, were inflation (using that term in its broad sense) absolutely prevented in the stock market, it would probably be forced in commodities and land; to some extent just this result occurred in 1918–21, following the necessary but artificial limitation on security loans during the war-time “money-control” period.

In Chapter IV upon “The Distribution of Securities,” the essential character of the floating supply of securities has been pointed out. The carrying of this floating supply of securities, or stock market inventory, is done with security loans, just as the similar unsold inventories of commodities are carried by commercial loans. Without security loans, securities could not be distributed, just as without commercial loans commodities could not be distributed. Security loans are not only legitimate

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<sup>25</sup> See Chapter V, p. 126.

but inevitably necessary in any country whose government or whose business companies depend on security issuance and distribution. Without the wisely provided facilities for carrying Liberty bonds in collateral loans (which incidentally proved highly speculative to millions of holders, and yet which were rediscountable at the Reserve banks), those enormous war issues could not have been effectively distributed.

Thus the economic services of security call loans might be briefly summarized as providing lenders with safe, liquid and flexible investments and thereby minimizing commodity or land inflation, and borrowers with funds which, while immediately used in security speculation and investment, ultimately facilitate the security distribution necessary to mass production, low manufacturing costs, high wages and high average standards of living in this country.<sup>26</sup>

**Preference for Commercial Loans.**—In modern banking practice, preference is always accorded to commercial over security loans.<sup>27</sup> This is due in part to the fact that when the tenets of modern commercial banking were formulated in England in the beginning of the nineteenth century, the wholesale merchant was the great outstanding figure in business, and the wholesale manufacturer who needed to obtain elaborate productive equipment by the sale of company securities had not yet appeared. But, although this condition has since been reversed, there is still sound reason for granting preference to genuine commercial loans over security loans. For the general function of commercial loans proper is to enable foodstuffs and merchandise to be freely and readily transported and distributed from producer to consumer. This process is of course absolutely necessary not only to modern trade but even in part to an ability on the part of our population to exist. To take an extreme case, many mouths in Wall Street would soon go hungry if the transport of foodstuffs into New York City could not be readily financed.

<sup>26</sup> Appendix XII.

<sup>27</sup> See Appendix XIe.

The general function of stock market loans, as we have seen, is, by promoting security distribution and facilitating new security flotations, to finance the establishment of new productive equipment, and thus to assure industrial and commercial progress. Without a mechanism in its leading money market for making security loans, it would be impossible for any modern country to engage in wholesale or mass production with low costs and high wage levels. It is no mere coincidence that America, which has so conspicuously excelled in these economic achievements, should possess in the New York call loan market the broadest and most highly organized security loan market in the world. Nevertheless, existence is an even more fundamental need than progress, and thus commercial loans in general deserve the preference which is accorded to them by bankers here and in other countries. Both forms of loan are, however, vitally necessary to continued national prosperity, and therefore both are suitable investments for our commercial banks and also for rediscounting at a central bank of issue.

After the angry attacks which have been made on our banking system for allowing funds which are alleged to be needed very desperately in our fields and factories to be "wasted in the stock market," it may surprise the layman that in reality stock market loans do not to any important extent compete for the money supply with commercial loans, that only the excess funds which bankers cannot safely lend in commercial loans are loaned in stock market loans, that usually the latter bear a lower rate of interest than the former, and that as far as "waste" is concerned there is no record of a lender's money being actually lost when loaned to a Stock Exchange house on listed security collateral. Senate Document 262, 66th Congress, 2nd Session (pp. 9-10) states: "The rates of call money do not determine and have not exerted an important influence on the rates for commercial borrowings."

In respect to this alleged tendency of the New York call loan market to draw away from interior centers funds needed

there by merchants, farmers, and others, it is well to remember that: (1) usually call loan rates rule below local interior interest rates on bankers' advances, and thus provide no incentive for diverting funds to New York; (2) local interior bankers are guided by self-interest to lend their funds locally rather than on call in New York, since the former loans create deposits, and thus increase the local bank's size and income and also build up the local community and turn fresh loans and deposits into the local bank, while New York call loans possess none of these advantages to the local lender; (3) such call loans as local interior banks make are therefore due to the need of placing a certain amount of the bank's funds in unquestionably safe and liquid investments, under penalty of the suspension or insolvency of the bank itself; and (4) the extensive insolvencies of local American banks during recent years go to show that many such institutions have, for the good of their own communities no less than their own, loaned too little rather than too much of their funds in the New York call loan market.<sup>28</sup>

In recent years there has been a noticeable tendency for companies to provide themselves with working capital by issuing new stocks or bonds rather than making short-term commercial loans at the banks. Such new issues as a rule cannot be immediately and completely sold to outright investors, and the amount remaining over and above investment purchases must be carried in the market floating supply by security loans for which they serve as collateral. The practical effect in banking of this marked tendency is, that security loans are now largely resorted to instead of commercial loans to furnish not only fixed but also working capital to our corporations. As company mergers and consolidations proceed, and as our companies themselves continue to prosper, this trend away from commercial to security loans has constantly become more pronounced, and ultimately it may revolutionize the basic methods and technique of American commercial banking.

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<sup>28</sup> See Appendix XIk.



**Services of the Call Loan Market in the 1919-21 Crisis.—**

In the critical period of 1919-21, the Stock Exchange loan market, although by legal discrimination denied the rediscount privilege at the Reserve Banks, came powerfully to the assistance of commercial loans, when their vaunted ability of "self-liquidation" had in practice badly broken down.<sup>29</sup>

In 1919-20 commercial bankers were able to extend further credit through commercial loans to farmers, merchants and manufacturers largely through liquidation of stock market loans, which declined from their peak of \$1,518,084,000 on November 14, 1919 to \$973,074,000 on October 15, 1920, while all loans, discounts, and investments of the Federal Reserve member banks rose from \$15,422,357,000 on the former date to a peak of \$17,283,996,000 on the latter date. These figures on the accompanying chart (Figure 23) are sufficient to show that within this critical period of about a year, \$545,010,000 was obtained by deflating the stock market, and loaned with \$1,316,629,000 additional, for other purposes.<sup>30</sup> Yet this is just the period when it was claimed that money was withheld from merchants, farmers, and manufacturers to lend to wicked stock market speculators! As Governor Benjamin Strong pointed out in the "Agricultural Inquiry" hearings in 1921:

I wish to call the commission's attention to the important fact . . . that the peak, in volume, of loans on the New York Stock Exchange was in the first part of November, 1919. . . . From that point it is almost a precipitate decline down to the present time, whereas the volume of all loans by all reporting banks during that period increased and did not reach their peak until October . . . of 1920, nearly a year later. If any inferences are justified . . . they would be, I think, two: one that, as is commonly regarded to be the case, financial markets anticipate movements more promptly than other markets, and, second, that the liquidation in the New York stock market started a year earlier than the liquidation throughout the country; and the effect of it was actually to release credit for purposes such as agricultural and industrial and commercial uses.

<sup>29</sup> See testimony of Governor Strong, *Agricultural Inquiry*, pp. 626-682, and also in "Stabilization" hearings, pp. 369, 438.

<sup>30</sup> See Chapter II, p. 55, and Appendix IIe.

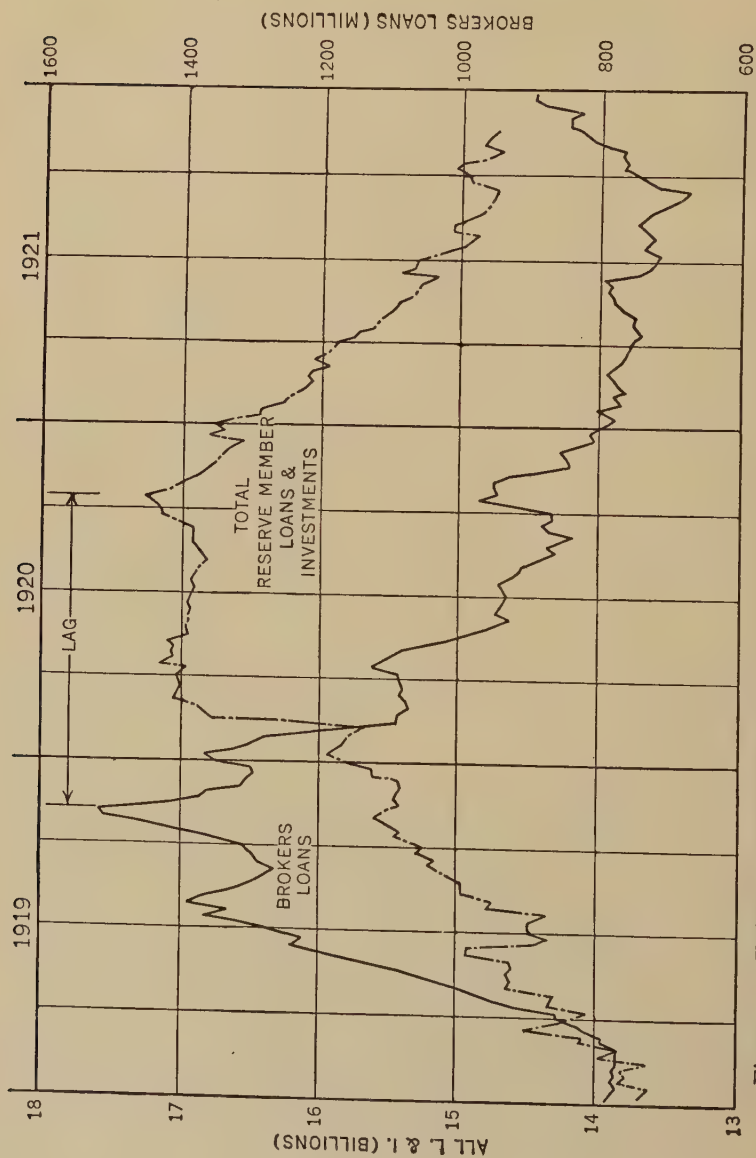


Figure 23. Federal Reserve Member Brokers' Loans and Total Loans and Investments, 1919-1921  
Showing earlier liquidation of brokers' loans under conditions of credit stringency.

Thus, during the credit strain in 1920, commercial bankers were frequently assisted in the difficult task of readjusting and strengthening their position by being able to call in their outstanding security collateral loans and thus protect their frequently illiquid commercial loans. As the authorities of one of the largest Wall Street banks stated at the time.<sup>31</sup>

The crisis of 1920 demonstrated the fact that loans to the stock market were the most liquid resources which the New York banks possessed. . . . Loans to the stock market proved to be an extremely valuable liquid resource, and the ability of the stock market to absorb securities, supplying the banks with new cash to lend for other purposes, eased the situation greatly.

The much discussed commercial "deflation" of 1920-21<sup>32</sup> revealed itself in the fall of total loans, discounts, and investments of reporting Reserve members from their peak of \$17,283,996,000 on October 15, 1920 to a low point of \$14,726,585,000 on September 7, 1921. During the same period, stock market loans fell from \$973,074,000 to \$680,448,000. In percentages, a 14% deflation in total member bank loans, discounts and investments was thus accomplished largely by means of a 55% deflation in stock market loans, of which 26% occurred before and 29% occurred after, the peak of all credit extension on October 15, 1920. The earlier arrival and greater severity of stock market than other deflation here revealed, is typical of the stock market's function as a capital market for surplus funds,<sup>33</sup> and as a stabilizing factor in our capital and credit markets.

**The Size of Security Loans Outstanding.**—The chief factors responsible for increases and decreases in the outstanding amounts of stock market loans have to do with both money and securities. On the money or supply side, both capital and credit are conditioning factors. Capital, which represents wealth permanently saved from present consumption, results

<sup>31</sup> A. Barton Hepburn and Benjamin M. Anderson, "The Gold and Rediscount Policy of the Federal Reserve Banks," *The Chase Economic Bulletin*, Vol. I, No. 5.

<sup>32</sup> See Appendix XI.

<sup>33</sup> See Chapter II, p. 53.

from individual or corporate thrift rather than from banking operations, and only to a partial extent can banks control its flow, increase or decline. Credit, which represents a temporary substitute for wealth, is created mainly by banks and can therefore be controlled and reduced by them. Both capital and credit naturally flow into the surplus capital market for security loans to the extent that they are not needed elsewhere for commercial loans and the like, and the more abundant they are, naturally the greater security loans tend to become. The limits upon credit expansion naturally consist in banking solvency and the maintenance of the gold standard. The chief limits to the creation of capital are the earning power and thrift of the nation, rather than any mechanical feature of our banking or currency system.

In respect to the demand or security side of the question, security loans tend to increase as the amounts of new security flotations become larger, as old securities become more negotiable through listing on a stock exchange, as wealth itself tends to become more negotiable by being expressed in the form of securities, as securities rise in price and thus require more funds to carry the same number of bonds or shares in the floating supply, and as resales of securities from investors back to market traders tend to increase the proportion of outstanding securities carried in the market floating supply.

**"Brokers' Loans," 1926-29.**—Borrowings of New York Stock Exchange members increased from \$3,513,174,154 on February 1, 1926 (when the Exchange began to collect and publish these statistics) to a "peak" of \$8,549,383,979 on October 1, 1929, and thereafter declined to \$3,984,768,065 on February 1, 1930. This expansion during 1926-29 gave rise to a controversy concerning "brokers' loans" of almost national scope, which at this writing has not altogether subsided. During this period the demand for the loans arose principally from rising share prices, large flotations of new securities, expansion of listings on the New York Stock Ex-

change and on other American stock markets, and the accumulation of a large "floating supply" or stock market inventory of securities held by dealers on credit rather than by investors. The funds employed in these loans came not only from American and foreign banks, but also (particularly during 1929) from American corporations, finance companies and individual investors; this latter group was designated "other lenders."

Owing alike to the rise in the loan totals and the restrictive credit policies of the Federal Reserve system, call loan interest rates rose in the spring of 1929 to 20%. The high rates, however, only drew into the loans more funds from "other lenders," and thus resulted in increases rather than decreases in the loan totals. In September, 1929, the stock market declined gradually, yet heavy flotations of new securities led to further expansion in the loans. The stock market panic broke out on Thursday, October 24, when reported sales totaled more than 12,000,000 shares, and reached its height Tuesday, October 29 when reported sales of 16,400,000 shares (or, counting in odd-lots and other non-reported sales, over 23,000,000 for the day). After a rally, there was a further slump during early November; by November 14 the panic was over. During the critical week of October 23-30, "brokers' loans" (according to Federal Reserve statistics) declined \$1,095 millions; but, whereas "other lenders'" loans fell \$1,381 millions, and loans by out-of-town banks \$707 millions, loans by New York banks increased \$993 millions. Thus New York banks during the crisis not only did not call their loans, but courageously took over about a billion of loans which other lending parties had called. The loans were, however, liquidated by the borrowing brokers so rapidly that this additional advance by New York banks to the stock market was retired in the next few weeks.

The call loan situation in 1929 afforded a strong contrast to that prevailing during the crisis ten years before. In 1919-20, the United States suffered from an acute shortage of credit which caused high call rates, and a liquidation of the



stock market under great pressure from the money market. In 1929 no credit shortage was actually present. Although call rates had risen high in the spring, they stood at about 6% only when the stock market decline began in the fall; at no time during the panic did call rates exceed 7%, and after it they became unusually low. This absence of money market pressure on the stock market partially accounts for the fact that in 1929 the stock market did not discount far in advance the trade depression, the fall in commodity prices, and the liquidation of commercial loans, as it had in 1919-20. In both periods, inflation occurred not only in the stock market but also in trade and industry. Concerning call loans in 1929, however, the really significant fact is that, had the funds employed in stock market credits been employed in commercial loans instead, the commercial and industrial inflation would have been vastly worse than it actually was. For, as nature abhors a vacuum, just so banks abhor idle funds. Artificial restriction of brokers' loans in the face of a national surplus of credit and capital could only have resulted in an even more dangerous and undesirable inflation of commercial loans. The principal moral seems to be, that an increased tendency toward stock market inflation is to some extent the price of being a creditor nation and having a genuine surplus of funds.

**Term Settlements.**—The New York Stock Exchange has long been urged to adopt term settlements of the sort practised on European stock exchanges, in order to place stock market financing on a time loan rather than a call loan basis, and to increase the efficiency of its central clearance and settlement. The authorities of the Exchange have been less inclined to consider the term settlement any panacea.<sup>34</sup> In 1926 the author made an extensive study of the question in London, Paris, and Berlin, and 1927 supplemented it by further researches in Amsterdam, Milan, Vienna, and other European centers. In his opinion, a term settlement could not prove in New York as

<sup>34</sup> See Address of President E. H. H. Simmons, "Speculation in Securities," before the New Hampshire Bankers Association, May 24, 1929, pp. 13-18.

satisfactory as the present cash settlement for many reasons inherent not only in the New York money and stock markets, but in the whole economic character of the United States. To mention only one drawback, a term settlement would at once lead to much greater speculative trading, since traders would be dealing entirely in open contracts until the arrival of settlement day. It was for this and other reasons that the shrewd *Amsterdamsche Beurs*, some years ago, refused after careful investigation to establish a term settlement in their market which, like that on the New York Stock Exchange, had long been on a cash settlement basis. The collapse of term settlement systems in Europe during the war has, even after their subsequent resumption, made them less popular there than prior to 1914. Many conservative firms in London today refuse to "carry-over" or "contango" securities bought for the account. In the writer's opinion, the New York Stock Exchange should not attempt to tear down and disorganize the present highly perfected call loan system, for the sake of benefits which appear more likely on theoretical than upon realistic and practical grounds. While the foreign term settlement systems may satisfactorily meet existing conditions in foreign security markets, under the totally different economic conditions in this country they would not afford any genuine improvement in our financial markets over indigenous and existing American methods.

**Rediscounting Security Loans.**<sup>85</sup>—The Reserve Act specifically forbids rediscounting of collateral loans upon other than U. S. Government collateral. The inability of the Reserve Banks to rediscount security loans keeps them out of direct contact with the security loan market—the largest and most highly organized section of the New York money market—and thereby interferes with their ability to lead and on occasion to control it. For to make its policies effective in the security loan market, the Reserve system must relax or tighten credit as

<sup>85</sup> See Address of President E. H. H. Simmons in Chicago, May 9, 1929, on "Stock Market Loans," pp. 31-33.

a whole. Moreover, there has been an ominous decline in the outstanding amounts of open-market paper or securities now eligible for rediscount; the commercial paper business has been slowly drying up as companies have been obtaining their working capital from new security issues, the rapid reduction of our national debt has reduced and threatens further to reduce the Reserve's dealings in U. S. Government securities or the collateral loans based upon them; and the bill market in New York seems likely to grow only gradually in accord with the increase in our foreign trade. The price of over-limitation of eligibility for rediscount, if these tendencies continue, is bound to be an increasing limitation upon the power, importance and prestige of the Federal Reserve system. It seems likely that the technique of rediscounting security loans so as to prevent the undue or inflationary employment of Reserve credit in the stock market, or interference with flexibility of the note issue, could be mastered by Reserve authorities if they were permitted by Congress to undertake it.

## CHAPTER XII

### COMPARISON AND SECURITY CLEARANCE

**Only Negotiation of Contracts on the Exchange.**—The New York Stock Exchange system consists of four essentially different parts:<sup>1</sup> (1) its floor, or market; (2) its central clearing and settling mechanism; (3) its commission houses through which the public has access to its market; and (4) its administrative organization. Previous chapters have analyzed and described the first of these parts—the Stock Exchange floor where its members, as specialized brokers and dealers, make contracts with each other. It is now necessary to proceed to the consideration of the second part of the Stock Exchange system—its subsidiary Stock Clearing Corporation where these Stock Exchange contracts are cleared and settled.

In Chapter VI we watched Jenkins and Wilkins, two commission brokers, effect a sale of 100 shares of Steel common at 150 on the floor of the Stock Exchange. It is highly important to notice that they exchanged no actual stock certificates or money there, but simply made a contract to deliver stock and pay money later. Since every sale is in reality an exchange of money and goods, Jenkins as the seller contracted to receive \$15,000 as well as to deliver the 100 shares of Steel, while Wilkins as the buyer contracted to deliver \$15,000 as well as to receive the 100 shares of stock. As we saw, each broker made a report of the transaction, which was sent to their own respective offices by their telephone clerks. It was then left for their offices, and not for Jenkins and Wilkins personally, to see that the money and the stock involved by this contract should be properly paid and delivered.

The New York Stock Exchange has a "daily settlement"

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<sup>1</sup> See Chapter III, p. 84.

system.<sup>2</sup> In the vast majority of cases, and always unless otherwise stated at the time of negotiation, sales of shares made on the New York Stock Exchange are made "regular way" for delivery by 2:15 P.M. upon the next full business day after the date of contract. Transactions occurring on Fridays and on Saturdays (on the latter day the Exchange closes at 12 M.) are cleared on Saturday, but settled the following Monday.

Under the limitations prescribed in its Constitution,<sup>3</sup> however, the time which may elapse between the negotiation and the settlement of a Stock Exchange contract, may be determined by special agreement when the contract is made. With a "cash" transaction, stock must be delivered and money paid on the very day of negotiation. Contracts may also be fixed "at three days," for settlement on the third day after negotiation. Many bonds, as has been pointed out,<sup>4</sup> are sold for a "deferred delivery" of seven days. Furthermore, delivery may be arranged according to "buyer's" or "seller's" option for not less than four or more than sixty days. Under a seller's option, the seller can deliver the stock and demand payment for it on any day within the period of the option, provided he notifies the buyer by 2:15 the previous day, while the buyer during the life of a buyer's option can similarly pay his money at any time and call for his stock. With bonds,<sup>5</sup> deliveries are frequently deferred until the seventh day following the date of contract. All these different deliveries except those for "cash" are susceptible of being handled through the Stock Clearing Corporation.

#### Stages of the Security Clearing and Settling Process.—

After a security contract is negotiated on the Stock Exchange, there are five basic processes through which it must pass before it is finally settled. First, both buyer and seller must signify to the Stock Clearing Corporation and to each other their agreement as to its essential terms—this process is known as

<sup>2</sup> See Chapter XI, p. 276.

<sup>3</sup> See Constitution (Rules, Chapter I).

<sup>4</sup> See Chapter X, p. 270.

<sup>5</sup> See Chapter X, p. 270.



"comparison." Second, a security clearance may or may not occur, depending primarily on whether it is an active or inactive security. Third, the security (or, if cleared, the security balance) must be delivered. Fourth, a clearance of the money value of security deliveries occurs. Fifth and finally, the money settlement must be made.

It is somewhat difficult to describe these several processes, for the New York Stock Exchange clearance and settlement system has grown up section by section, is in part optional with members, sometimes differentiates in its methods between different classes of securities or different individual security issues, is still rapidly expanding, and has as yet by no means reached the end of its possible and even probable future evolution. In principle, stock exchange clearing and settling systems are no different than bank clearing houses or the Gold Settlement Fund of our Federal Reserve system. They are, however, much more complex, for where a bank clearing house handles only the one commodity of bank funds, or the Gold Settlement Fund the one commodity of gold, a stock clearing house must handle both money and securities, and often many completely different issues of securities too. In addition, stock clearing systems sometimes perform for their members other important functions beside simply the clearance and settlement of their sales contracts with each other. In this and the following two chapters the attempt will be made to describe these several related functions as clearly as possible, and at the same time as nearly as possible in their actual sequence.

**The Pre-Stock Clearing Corporation Days.**—The first complete system of stock clearance was inaugurated at Frankfurt, and the important economies which it effected soon led to the development of similar systems in London, Paris, Vienna, Berlin, Hamburg, and other European centers. Today, only Amsterdam of the important financial stock exchanges has no clearing and settling system. In America, the first

attempt to clear stocks was made by the Philadelphia Stock Exchange. The New York Stock Exchange was comparatively slow to inaugurate a clearing system, and its original "Clearing House of the New York Stock Exchange" was not established until May 17, 1892—the centennial of the first brokers' agreement from which the Exchange itself had developed.<sup>6</sup>

Before 1892, Stock Exchange members "compared" their trades by exchanging "comparison tickets," and some members would for a fee themselves clear stocks for other members. The "Clearing House of the New York Stock Exchange" undertook to clear intermediary transactions in certain securities, both as to the securities themselves and their money values, but it provided no means for centralized security deliveries, or for any further clearance or settlement of money. The "Clearing House" was administered by paid managers under the supervision of a former standing sub-committee of the Stock Exchange Governing Committee.

**Establishment of the Stock Clearing Corporation.**—So matters stood until 1920, when the continued growth of the New York stock market, as well as the tremendous strain upon American credit conditions during and after the Great War, rendered it desirable for the Exchange to establish further facilities for money clearance and settlement, in order to effect economies in time, labor, and banking accommodation.

This step compelled far-reaching changes in the entire system, which was reorganized as the "Stock Clearing Corporation" whose share capital of \$500,000 is all owned by the New York Stock Exchange. The Corporation is in no sense a bank, but simply an agency for its members whereby the delivery, clearance, and settlement of security transactions can be effected with the maximum speed, safety, and economy. At present it has about 425 clearing members—all of them Stock Exchange firms. The Stock Clearing Corporation has a clear-

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<sup>6</sup> See Appendix XIIa.

ing fund of over \$10,000,000 to which clearing members contribute in proportion as they employ the Corporation's services. This fund is kept in the form of deposits in approved banks and trust companies. The fund carries with it an assessable liability of 100% to every clearing member. The expenses of the Corporation are covered by charges to its members on the money value of such securities as are cleared, interest on money on deposit, charges on shares cleared in the Night Branch, and fines. Under its Constitution and rules, the Stock Clearing Corporation is administered by its President and a Board of Directors largely composed of members of the Governing Committee of the New York Stock Exchange.

**The Night and Day Branches.**—The work of the Stock Clearing Corporation is performed by two different branches. Its Night Branch is the earlier "Clearing House of the New York Stock Exchange," rechristened and modified in certain details so as to fit with the present more inclusive system of clearance and settlement. Its Day Branch, on the other hand, dates from 1920 and performs, as we shall see, a wide variety of functions and services. The names of these branches are derived from the fact that the former operates in the evening beginning about 6 P.M., while the latter performs its work in the daytime from 9 A.M. to about 5 P.M. Where the Night Branch clears both money and security amounts, the Day Branch clears only money amounts and for this reason more closely resembles a bank clearing house. Also, in the process of handling a given Stock Exchange contract, the Day Branch begins its operations where the Night Branch leaves off. The work of the Day Branch will be considered in Chapters XIII and XIV, while that of the Night Branch will constitute the theme of the present chapter.

**Scope of the Night Branch Security Clearance.**—By no means all the securities listed on the New York Stock Exchange are cleared in the Night Branch. Bond clearances are made only in the most active listed issues. Moreover, out of

over 1,300 stock issues now listed, only about 450 are at present cleared, for in practice it has been found that no economies can be effected by clearing any issues except those actively dealt in upon the Stock Exchange. Also, except on special occasions, the Night Branch does not clear odd-lot transactions in from 1 to 99 shares, but confines itself to transactions in round lots of 100 shares or multiples thereof.<sup>7</sup> However, the volume of stock transactions which are cleared averages about 90% of the total sales of stock recorded upon the Stock Exchange stock ticker tape.

Thus, from the viewpoint of security clearance and settlement, Stock Exchange listed securities can be divided into the "cleared" and "non-cleared" stocks and bonds, and this distinction is preserved largely throughout the whole process.

**Comparisons.**—The process of comparison constitutes the initial step in the whole process of security clearance and settlement.<sup>8</sup> We have seen that when Jenkins and Wilkins make their contract for "100 Steel at 150" on the Exchange, each broker at once sends a report of the transaction to his own office in Wall Street. It remains for these two brokerage offices to compare, in order to make sure that they are in exact agreement as to the terms of the contract which their "floor members" have just made. Until the Stock Clearing Corporation has evidence to this effect from both members, it will not undertake to clear or settle the transaction.

In every Stock Exchange house, the clerks keep "blotter" records of transactions which their firms have currently made on the floor. Transactions in cleared securities are entered on the "Clearing House blotter," while those in other securities are recorded separately.<sup>9</sup> In making comparisons, "exchange tickets" are employed for cleared securities, "three-way tickets" for non-cleared stocks and for non-cleared bonds settled "regular way," and "four-way deferred delivery bond contract

<sup>7</sup> See Chapter IX, p. 251.

<sup>8</sup> See Appendix XIIb.

<sup>9</sup> See Chapter XV, p. 418.

tickets" for non-cleared bonds to be settled for deferred delivery.

**Exchange Tickets.**—When a transaction has occurred in a cleared stock, in the buyer's office, a yellow "receive exchange ticket" (Figure 24) printed in black is prepared, and in the seller's office a white "deliver exchange ticket" (Figure 25a) printed in red. The seller's "deliver exchange ticket" is provided with a detachable sales ticket (Figure 25b), upon which are affixed the Federal and State stock sales tax stamps;<sup>10</sup> the sales ticket is then torn off by the delivering member and sent to the Stock Clearing Corporation by 11 o'clock the next day.

|                                                           |                |                          |                               |
|-----------------------------------------------------------|----------------|--------------------------|-------------------------------|
| Form-241                                                  | No. <u>410</u> | Our Line Number <u>7</u> | New York <u>July 1st</u> 1929 |
| <b>STOCK CLEARING CORPORATION (NIGHT CLEARING BRANCH)</b> |                |                          |                               |
| <b>RECEIVE FROM</b> <u>Jenkins &amp; Co.</u>              |                |                          |                               |
| <u>100 shares U. S. Steel common @ 150</u> \$15,000       |                |                          |                               |
| for account of the undersigned.                           |                |                          |                               |
| Their Line Number <u>51</u>                               |                | <u>Wilkins &amp; Co.</u> |                               |

Figure 24. Receive Exchange Ticket

These "exchange tickets" derive their name from the fact that they are exchanged, the "deliver" ticket going to the receiving member, and the "receive" ticket to the delivering member; this exchange is effected through the Distributing Department of the Night Branch. Since the tickets are memoranda of the same transaction, their exchange serves to effect a comparison between the two parties as to its terms. But "exchange tickets" are also positive and legally binding orders upon the Stock Clearing Corporation, stamped with the issuing firm's name, to deliver or to receive the specified stock to or from the other indicated firm. Thus the Stock Clearing Corporation obtains from both firms the authority to effect in their behalf deliveries and receipts of cleared securities, for which the "exchange tickets" are exclusively used.

<sup>10</sup> See Chapter VIII, p. 207.



No. 400 Our Line Number 51 New York July 1st 1929

STOCK CLEARING CORPORATION (NIGHT CLEARING BRANCH)

**DELIVER TO** Wilkins & Co.

100 shares U. S. Steel common @ 150 \$ 15,000  
for account of the undersigned.

Their Line Number 7 Jenkins & Co.

Figure 25a. Deliver Exchange Ticket  
Blank section at bottom is reverse of 25b.

No. 400 Our Line Number 51 New York July 1st 1929

Subject to the Revenue Act of 1924, and regulations made in accordance therewith.

**SOLD TO** Wilkins & Co.

100 shares U. S. Steel common @ 150 \$ 15,000

Their Line Number 7

Figure 25b. Sales Ticket  
Blank section at top is reverse of 25a.

**"Three-Way Exchange Tickets."**—Comparison is made for all transactions in non-cleared stocks, and for all transactions in non-cleared bonds made for "regular way" delivery, by means of the "three-way exchange tickets." This form on buff paper consists, as its name implies, of three detachable tickets: (1) a form retained by the receiver; (2) a receiver's exchange ticket; and (3) a deliverer's exchange ticket. The first and third parts are printed in red, the second in black (Figure 26). By means of carbon paper all three are made out at once by the deliverer, except of course for the receiving member's signature. The deliverer then sends the triple form to the receiver, who retains one of its "deliver" tickets and returns the remaining "deliver" and "receive" tickets to the deliverer; this is done through the Distributing Department of the Night Branch, and serves as a comparison. For the receiver will not sign the receiver's exchange ticket until he ascertains that the seller's notation on it as to the identity, amount and price of the securities upon it agrees with his own records of the transaction. The "exchange tickets" are not an order by the firms on the Stock Clearing Corporation to deliver or receive for them, since the securities in this case are not cleared at its Night Branch. They are, as we shall presently see,<sup>11</sup> used later on in connection with the establishment of the firms' contingent credits and debits in the Day Branch money clearance and settlement.

**"Four-Way Deferred Delivery Bond Contract Tickets."**—It has been pointed out<sup>12</sup> that in bond transactions, a system of deferred delivery is frequently employed, whereby the delivery is made on the seventh full business day following the day of contract, but may be made on any full business day prior thereto upon one day's notice by the seller. Such deferred delivery transactions in bonds make necessary a special method of comparison, in which a quadruplicate blue form is used: (1) a deliver bond contract; (2) a receive bond contract; (3)

<sup>11</sup> See Chapter XIV, p. 385.

<sup>12</sup> See Chapter X, p. 270.

|                                                                                          |                       |                                                 |                        |            |               |
|------------------------------------------------------------------------------------------|-----------------------|-------------------------------------------------|------------------------|------------|---------------|
| Clearing No. <u>400</u><br>(Delivering Member)                                           |                       | Blotter Line No. <u>7</u><br>(Receiving Member) |                        |            |               |
| Securities not entered on previous Night Clearing Sheet                                  |                       |                                                 |                        |            |               |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                        |                       |                                                 |                        |            |               |
| New York, <u>July 2nd</u> 192 <u>9</u>                                                   |                       |                                                 |                        |            |               |
| Blotter Line No.<br>Delivering<br>Member                                                 | (Receiving Member)    | Shares<br>Delivered                             | Security               | Price      | Value         |
| <u>24</u>                                                                                | <u>Rose &amp; Co.</u> | <u>100</u>                                      | <u>Nat Biscuit pfd</u> | <u>140</u> | <u>14 000</u> |
| the undersigned will deliver the above                                                   |                       |                                                 |                        |            |               |
| To <u>Rose &amp; Co. 450</u><br>(Name and Number Stamp of Receiving Member)              |                       |                                                 |                        |            |               |
| for account of the undersigned                                                           |                       |                                                 |                        |            |               |
| Account of <u>Rose &amp; Co.</u> <u>Jenkins &amp; Co.</u><br>(Name of Delivering Member) |                       |                                                 |                        |            |               |

Figure 26a. "Three-Way Exchange Ticket"—the ticket retained by the receiver

|                                                                                                              |                    |                                                 |                        |            |               |
|--------------------------------------------------------------------------------------------------------------|--------------------|-------------------------------------------------|------------------------|------------|---------------|
| Clearing No. <u>400</u><br>(Delivering Member)                                                               |                    | Blotter Line No. <u>7</u><br>(Receiving Member) |                        |            |               |
| Securities not entered on previous Night Clearing Sheet                                                      |                    |                                                 |                        |            |               |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                                            |                    |                                                 |                        |            |               |
| New York, <u>July 2nd</u> 192 <u>9</u>                                                                       |                    |                                                 |                        |            |               |
| Blotter Line No.<br>Delivering<br>Member                                                                     | (Receiving Member) | Shares<br>Delivered                             | Security               | Price      | Value         |
| <u>24</u>                                                                                                    | <u>[REDACTED]</u>  | <u>100</u>                                      | <u>Nat Biscuit pfd</u> | <u>140</u> | <u>14 000</u> |
| the undersigned will receive the above                                                                       |                    |                                                 |                        |            |               |
| From <u>Jenkins &amp; Co. 400</u><br>(Name and Number Stamp of Delivering Member)                            |                    |                                                 |                        |            |               |
| for account of the undersigned                                                                               |                    |                                                 |                        |            |               |
| Account of <u>Rose &amp; Co.</u> <u>Rose &amp; Co. 450</u><br>(Name and Clearing Number of Receiving Member) |                    |                                                 |                        |            |               |

Figure 26b. "Three-Way Exchange Ticket"—the receiver's exchange ticket

|                                                                                          |                       |                                                 |                        |            |               |
|------------------------------------------------------------------------------------------|-----------------------|-------------------------------------------------|------------------------|------------|---------------|
| Clearing No. <u>400</u><br>(Delivering Member)                                           |                       | Blotter Line No. <u>7</u><br>(Receiving Member) |                        |            |               |
| Securities not entered on previous Night Clearing Sheet                                  |                       |                                                 |                        |            |               |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                        |                       |                                                 |                        |            |               |
| New York, <u>July 2nd</u> 192 <u>9</u>                                                   |                       |                                                 |                        |            |               |
| Blotter Line No.<br>Delivering<br>Member                                                 | (Receiving Member)    | Shares<br>Delivered                             | Security               | Price      | Value         |
| <u>24</u>                                                                                | <u>Rose &amp; Co.</u> | <u>100</u>                                      | <u>Nat Biscuit pfd</u> | <u>140</u> | <u>14 000</u> |
| the undersigned will deliver the above                                                   |                       |                                                 |                        |            |               |
| To <u>Rose &amp; Co. 450</u><br>(Name and Number Stamp of Receiving Member)              |                       |                                                 |                        |            |               |
| for account of the undersigned                                                           |                       |                                                 |                        |            |               |
| Account of <u>Rose &amp; Co.</u> <u>Jenkins &amp; Co.</u><br>(Name of Delivering Member) |                       |                                                 |                        |            |               |

Figure 26c. "Three-Way Exchange Ticket"—the deliverer's exchange ticket

a deliver exchange ticket; and (4) a receive exchange ticket; the first and third tickets are printed in red, and the second and fourth in black (Figure 27).

The deliverer makes out this fourfold form and sends it to the receiver, who removes and retains the "deliver bond contract" (if correct) and returns the remaining three forms to the deliverer; this is done through the Distributing Department of the Night Branch, and serves as a preliminary comparison. When the actual delivery is to be made, on the day preceding the deliverer retains the "receive bond contract" and sends the remaining two deliver and receive exchange tickets to the receiver, who signs the receive exchange ticket, and sends both tickets back to the deliverer again; this is done through the Distributing Department of the Night Branch. In this way, a second comparison is effected, and, as will be noted later,<sup>18</sup> the tickets are subsequently used to establish the firm's contingent credits and debits in the Day Branch money clearance and settlement.

**The Distributing Department of the Night Branch.**—Originally, all exchange and comparison tickets had to be sent by the seller directly to the offices of the different buyers. In 1916 the old Clearing House established a central Distributing Department to effect economies and greater regularity in the process. This Distributing Department is housed in the quarters of the Night Branch at 55 New Street.

In the Distributing Department a locked box with a letter slot is provided for every clearing member. Every day after 10 A.M. messengers of Exchange houses come to this office and place in their respective boxes the exchange and comparison tickets, both to deliver and to receive, which their particular firm is sending to all other Stock Exchange firms. This done, each messenger then goes to the box of his own firm, unlocks it, withdraws all the deliver and receive exchange and com-

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<sup>18</sup> See Chapter XIV, p. 385.

parison tickets which other firms have sent to it, and takes them back to its own offices.

When, for example, Jenkins' messenger places his "deliver ticket" for the 100 Steel which he has sold to Wilkins & Co. in

| Clearing No. <u>400</u><br>(Delivering Member)                                                                                                                                                         |                       | DELIVER BOND CONTRACT                                                           |                        | New York<br>Contract Date <u>June 26, 1929</u>   |                |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------------------------------------------------------------------------|------------------------|--------------------------------------------------|----------------|
|                                                                                                                                                                                                        |                       | STOCK CLEARING CORPORATION<br>(DAY BRANCH)                                      |                        | Blotter Line No. <u>14</u><br>(Receiving Member) |                |
| Blotter Line No.<br>Delivering<br>Member                                                                                                                                                               | (Receiving Member)    | Bonds                                                                           | Security               | Price                                            | Value          |
| <u>17</u>                                                                                                                                                                                              | <u>Gray &amp; Co.</u> | <u>5</u>                                                                        | <u>City Rome 6 1/2</u> | <u>90</u>                                        | <u>4 500</u> — |
| the undersigned will deliver the above                                                                                                                                                                 |                       |                                                                                 |                        |                                                  |                |
| To <u>Gray &amp; Co. 500</u><br>(Name and Number Stamp of Receiving Member)                                                                                                                            |                       |                                                                                 |                        |                                                  |                |
| to whom the undersigned has sold the same on the date and at the price named, DELAYED DELIVERY, under the Constitution of the New York Stock Exchange and the Rules of the Stock Clearing Corporation. |                       |                                                                                 |                        |                                                  |                |
| Account of _____                                                                                                                                                                                       |                       | <u>Jenkins &amp; Co. 400</u><br>(Name and Clearing Number of Delivering Member) |                        |                                                  |                |

Figure 27a. "Four-Way Deferred Delivery Bond Contract Ticket"—the deliver contract form

| Clearing No. <u>400</u><br>(Delivering Member)                                                                                                                                                             |  | RECEIVE BOND CONTRACT                                                       |                        | New York<br>Contract Date <u>June 26, 1929</u>   |              |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|-----------------------------------------------------------------------------|------------------------|--------------------------------------------------|--------------|
|                                                                                                                                                                                                            |  | STOCK CLEARING CORPORATION<br>(DAY BRANCH)                                  |                        | Blotter Line No. <u>14</u><br>(Receiving Member) |              |
| Blotter Line No.<br>Delivering<br>Member                                                                                                                                                                   |  | Bonds                                                                       | Security               | Price                                            | Value        |
| <u>17</u>                                                                                                                                                                                                  |  | <u>5</u>                                                                    | <u>City Rome 6 1/2</u> | <u>90</u>                                        | <u>4 500</u> |
| the undersigned will receive the above                                                                                                                                                                     |  |                                                                             |                        |                                                  |              |
| From <u>Jenkins &amp; Co. 400</u><br>(Name and Number Stamp of Delivering Member)                                                                                                                          |  |                                                                             |                        |                                                  |              |
| from whom the undersigned has bought the same on the date and at the price named, DELAYED DELIVERY, under the Constitution of the New York Stock Exchange and the Rules of the Stock Clearing Corporation. |  |                                                                             |                        |                                                  |              |
| Account of _____                                                                                                                                                                                           |  | <u>Gray &amp; Co. 500</u><br>(Name and Clearing Number of Receiving Member) |                        |                                                  |              |

Figure 27b. "Four-Way Deferred Delivery Bond Contract Ticket"—the receive contract form

Wilkins' box, it is picked up later by Wilkins' messenger; in like manner Wilkins' "receive ticket" for the same transaction is put in Jenkins' box, and later picked up by Jenkins' messenger. The procedure would be just the same if the tickets were for non-cleared securities. By means of this Distributing Department a single messenger by a single visit to it can



deliver all the available tickets which his firm has to send to all other firms, and also to obtain all the tickets which all other firms have sent to his firm. This system naturally effects great economies in messenger hire by Stock Exchange

|                                                                                                  |                       |                                                  |                        |                                                |              |
|--------------------------------------------------------------------------------------------------|-----------------------|--------------------------------------------------|------------------------|------------------------------------------------|--------------|
| Clearing No. <u>400</u><br>(Delivering Member)                                                   |                       | <b>DELAYED DELIVERY (BONDS)</b>                  |                        | New York <u>June 26, 1929</u><br>Contract Date |              |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                                |                       | Blotter Line No. <u>14</u><br>(Receiving Member) |                        |                                                |              |
| (Settlement Date) New York <u>July 2nd, 1929</u>                                                 |                       |                                                  |                        |                                                |              |
| Blotter Line No. <u>17</u><br>Delivering Member                                                  | (Receiving Member)    | Bonds                                            | Security               | Price                                          | Value        |
|                                                                                                  | <u>Gray &amp; Co.</u> | <u>5</u>                                         | <u>City Rome 6 1/2</u> | <u>90</u>                                      | <u>4 500</u> |
| the undersigned will deliver the above                                                           |                       |                                                  |                        |                                                |              |
| To <u>Gray &amp; Co. 500</u><br>(Name and Number Stamp of Receiving Member)                      |                       |                                                  |                        |                                                |              |
| for account of the undersigned                                                                   |                       |                                                  |                        |                                                |              |
| Account of _____ <u>Jenkins &amp; Co. 400</u><br>(Name and Clearing Number of Delivering Member) |                       |                                                  |                        |                                                |              |

Figure 27c. "Four-Way Deferred Delivery Bond Contract Ticket"—the deliver exchange ticket

|                                                                                              |                    |                                                  |                        |                                                |              |
|----------------------------------------------------------------------------------------------|--------------------|--------------------------------------------------|------------------------|------------------------------------------------|--------------|
| Clearing No. <u>400</u><br>(Delivering Member)                                               |                    | <b>DELAYED DELIVERY (BONDS)</b>                  |                        | New York <u>June 26, 1929</u><br>Contract Date |              |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                            |                    | Blotter Line No. <u>14</u><br>(Receiving Member) |                        |                                                |              |
| (Settlement Date) New York <u>July 2nd, 1929</u>                                             |                    |                                                  |                        |                                                |              |
| Blotter Line No. <u>17</u><br>Delivering Member                                              | (Receiving Member) | Bonds                                            | Security               | Price                                          | Value        |
|                                                                                              |                    | <u>5</u>                                         | <u>City Rome 6 1/2</u> | <u>90</u>                                      | <u>4 500</u> |
| the undersigned will receive the above                                                       |                    |                                                  |                        |                                                |              |
| From <u>Jenkins &amp; Co. 400</u><br>(Name and Number Stamp of Delivering Member)            |                    |                                                  |                        |                                                |              |
| for account of the undersigned                                                               |                    |                                                  |                        |                                                |              |
| Account of _____ <u>Gray &amp; Co. 500</u><br>(Name and Clearing Number of Receiving Member) |                    |                                                  |                        |                                                |              |

Figure 27d. "Four-Way Deferred Delivery Bond Contract Ticket"—the receive exchange ticket

firms, and also greatly speeds up the making of comparisons between them each day. The Distributing Department is open until 5:30 P.M. on full business days, and until 2:30 P.M. on Saturdays.

**Conclusion of the Process of Comparison.**—If a deliver- ing and a receiving member do not agree as to the identity,

amount, or price of their transaction, the Stock Clearing Corporation refuses to act for them in clearing and settling it; the transaction is removed from the Corporation's clearing records, and declared "ex-Clearing House." Unless the parties to it can agree as to the terms of their contract, the case may be adjudicated by the Arbitration Committee, and in case of appeal from the latter's decision, by the Governing Committee. Meanwhile, the differences arising from the disputed comparison are reduced to money amounts by "purchase, sale, or mutual agreement."<sup>14</sup>

But in case no such disagreement occurs, all exchange tickets must be promptly delivered to the Distributing Department by 4:20 at the latest, in order that the firm to whom they are being sent can in turn send them to the Night Branch with its "Night Sheet." Somewhat more latitude is allowed with tickets for non-cleared securities, yet these too must be exchanged in time so that the Day Branch can in turn receive them the next morning in good season. Tardiness by members in these matters is subject to fine by the Stock Clearing Corporation. The time schedule applying to these processes has in recent years been more difficult to establish with exactitude owing to the increasing volume of business.<sup>15</sup>

By this process of comparison, all Stock Exchange transactions are checked by both parties to them, and preparation is made to afford to the Stock Clearing Corporation evidence of agreement as to their terms. Thus the first act of the settlement process is concluded, and the stage is set for its second act—that of security clearance.

**Theory of Security Clearance.**—Although the technique and practice of security clearance usually prove confusing to the layman, the theory of it is very simple. If A owes \$5 to B, and B owes \$5 to C, obviously both debts can be extinguished by a single payment of \$5 from A to C. Also, if A owes \$5 to B, and B owes \$10 to C, equally obviously all will

<sup>14</sup> See Chapter XVI, p. 454.

<sup>15</sup> See Appendix XIIc.

be satisfied if A and B pay C \$5 apiece. In the first case, B, the intermediary, is relieved of any need to pay anything except as he releases his claim on A, while in the second case B is relieved of as much of his indebtedness to C as he can claim from A, and needs only to pay the remaining balance to C. The essential economies effected by either bank or security clearing systems consist in this obviation of the really superfluous payments which an intermediary like B would otherwise have to make.

With security clearances, there is involved a double process involving securities as well as money. If Broker A sells 100 Steel to Broker B at 100 (\$10,000), and B proceeds at once to resell the same stock to Broker C at the same price, obviously both stock commitments and money obligations can all be extinguished at once if A will deliver the 100 Steel to C in return for C's payment to him of \$10,000. Here B is saved from needlessly receiving and delivering securities as well as money, and his intermediate contracts for 100 Steel and for \$10,000 also can be cleared for him by any system which can make sure that A and C fulfil their respective engagements.

Unfortunately for students of security clearing systems, however, stockbrokers rarely do business with each other in this way at exactly the same price. Broker A, let us suppose, sells 100 Reading to Broker B at 79, and B at once resells it at 81 to Broker C. The security clearing house can still effect a clearance of B's stock by instructing A to deliver the 100 Reading to C. But this is only half the story, for the money aspect of the clearance has still to be arranged. When A delivers the stock to C, the latter will expect to pay \$8,100 for it, or \$200 more than A sold it for. Meanwhile B, who bought it for \$7,900 and sold it for \$8,100 is looking for his profit of \$200, and will not be satisfied until he obtains it. If the clearing system attempted to let all the A's and B's search each other out and settle their differences with each other in this way, chaos would in practice result.

**Employment of Settlement or Delivery Prices.**—Accordingly, the clearing systems of all the great stock exchanges here or abroad resort to the use of the artificial but very handy device of a “delivery” or “settlement price,” at which all transactions in all cleared securities will at first be settled; afterwards, with every firm, an adjustment is made of the differences between the settlement prices it has thus employed and the actual prices at which it really bought and sold. Suppose this is done in the foregoing case, at a settlement price for Reading of 80. A delivers the 100 Reading to C, and C pays him \$8,000 for it. Thus A, who really sold it for \$7,900 gets \$100 too much, while C who really bought it for \$8,100 pays \$100 too little. But the clearing system knows this perfectly well, and calls upon each of them for \$100, which they pay to it forthwith. Meanwhile B is told to draw a draft against the system for his \$200, and this draft is paid from the proceeds of the two checks for \$100 already collected from A and C.

The New York Stock Exchange settlement prices are fixed by the Night Branch for each day's transactions, soon after the close of the market. The delivery price for each cleared stock is usually arrived at by selecting the nearest even price (excluding fractions) to the closing bid price for the day. Consequently, the settlement price on a closing bid of  $79\frac{1}{8}$  would be 79, or on a closing bid of  $79\frac{5}{8}$  would be 80. Sometimes, in the less active stocks, the price of the last sale is used, when the closing bid price is too weak to furnish a satisfactory basis. Thus, when the last sale of such a stock has been made at 86, and its closing bid and asked prices are 82–87, the delivery price might be made at 86.

**Preparing for the Night Clearance.**—All day long, as transactions are entered into by Stock Exchange members on the floor, they are reported back to their offices. Transactions in cleared securities are entered on the “clearing blotter” and exchange tickets dispatched to the other parties to each trade. When the corresponding exchange tickets from these respec-

tive parties are received by the firm they are then used to check against the entries for them on the firm's "night sheet" or "clearance sheet." This sheet, which is thus in process of preparation all day, is therefore a full record of all purchases and sales by the firm of cleared stocks that day. In addition, borrowed and loaned stocks may also appear upon it, as well as the purchases and sales of an Exchange member who is not a clearing member but who clears his transactions through the given firm.<sup>16</sup>

**A Typical Day's Business.**—Suppose that on July 1, 1929 Jenkins & Co. has purchased 1,000 shares of Reading, 500 shares of Steel, 600 shares of U. S. Rubber, and 100 shares of Otis Elevator, and has sold 800 Reading, 800 Steel, 600 Rubber, and 100 National Biscuit preferred. Since Reading, Steel, and Rubber are all cleared securities, they will be entered upon Jenkins' "night sheet" and be subject to security clearance, after his transactions in them have all been "compared" by the exchange of exchange tickets. But the Otis Elevator and the National Biscuit preferred are not cleared, and will not be entered or cleared upon his night sheet; after they have been compared by means of "three-way exchange tickets," they will be delivered without obviation. Similarly, if Jenkins had bought or sold any non-cleared bonds, they would similarly be omitted from his night sheet, compared with "exchange tickets," and delivered without obviation. On this basis, we must next examine in detail Jenkins' "clearance" or "night sheet" (Figure 28), among whose items will be found the sale of 100 Steel to Wilkins described in an earlier chapter.<sup>17</sup>

**The Clearance Sheet in Detail.**—Even at the expense of a somewhat tedious and perhaps puzzling foray into the dreary realm of bookkeeping, this clearance sheet will repay careful study, as it is fundamental to the whole system of stock clearance. In the upper right-hand corner there is a line on which

<sup>16</sup> See Chapter VIII, p. 204.

<sup>17</sup> See Chapter VI, p. 165.





the clearing number of the firm whose transactions the sheet records is placed. As we shall presently see, firms are known by these numbers rather than by their names in the Stock Clearing Corporation. In the upper left-hand corner the letters "EX" and "CK" will be noticed. These are abbreviations of "Examined" and "Checked," and refer to operations in the process of clearance which will presently be explained.

The sheet is divided down its center into two parts. On the left-hand side are recorded the stocks which Jenkins & Co. has bought and will receive when the clearance is finished, together with the name, number, and price of the stocks, and their cash extensions, or the amount of money they represent. The right-hand side of the sheet contains a similar record of the stocks which Jenkins & Co. sold during the day and must deliver before the clearance is completed. Prominent among these selling transactions will be found the 100 shares of Steel sold to Wilkins. In addition, loaned stock is included as stock to deliver, and borrowed stock as stock to receive, in the same manner as sold or purchased stock respectively.

**Stock Balances "To Receive" and "To Deliver."**—The clerk who prepares this clearance sheet next ascertains the balances of clearing house stocks which his firm has to receive and deliver. Jenkins & Co. has during this particular day bought 1,000 shares of Reading, 500 of Steel, and 600 of Rubber; and has sold 800 shares of Reading, 800 of Steel, and 600 of Rubber. In the case of Rubber there is no balance, since the firm has sold the same amount as it has bought. But it has sold 300 shares more Steel than it has bought, and has bought 200 shares more Reading than it has sold. Consequently, it has a balance of 300 Steel to deliver and of 200 Reading to receive. In order to strike a balance on the clearance sheet, the balances to deliver used to be entered under the stocks to receive, and the balances to receive under the stocks to deliver. The accuracy of this much of the record could

thus be proved by the total of 2,400 shares of stock appearing on both sides of the sheet. Recently, such balances have been entered and handled on separate sheets in order to facilitate the subsequent work of the Day Branch; for the sake of simplicity, however, the specimen clearing sheet here used has been made out in the old way.

**The Cash Extensions.**—Beside the entry for the stocks is a column for the prices at which they were bought and sold. Ordinarily this column is not filled, since the amount of the cash extension next to it gives this information. To make the sheet more intelligible to the layman, however, the prices have been entered in the typical sheet in question. The cash extension represented by each stock item is, of course, determined by multiplying the price by the number of shares; 100 shares of Reading at  $104\frac{3}{4}$  are worth \$10,475; 100 shares of Steel at 150 are worth \$15,000, etc.

The Stock Clearing Corporation will direct Jenkins & Co. to receive and deliver, not all the stocks it has bought or sold, but only the stock balances. Thus, Jenkins & Co. will have only 300 instead of 2,200 shares to deliver and obtain payment for, and only 200 instead of 2,100 shares to receive and pay for. But Jenkins & Co. cannot tell to what firm the Stock Clearing Corporation may direct it to deliver its balance of 300 Steel, or from whom to receive its balance of 200 Reading. Consequently, it would be at a loss to know what price to put upon these stock balances, were it not for the use of the "delivery prices" already mentioned. On this particular day the delivery price is 150 for Steel, and 105 for Reading. Consequently, Jenkins & Co. puts down on its sheet \$45,000 as the value of the stock balance of 300 Steel it has to deliver, and when it delivers this stock to the firm or firms indicated by the Stock Clearing Corporation it will expect this sum in return for its stock. Also, Jenkins & Co. will pay \$21,000 for the 200 shares of Reading which it has to receive.

**Inclusion of Loaned and Borrowed Stocks.**—In an earlier chapter<sup>18</sup> it was pointed out that a broker is able to deliver to the purchaser stock which he has sold short by borrowing it from some other broker in exchange for a loan of money equivalent to the market value of the stock borrowed. Such loans and borrowings of stock and their money equivalents are included in the clearance sheet, exactly as if they were sales and purchases. If, for example, Jenkins & Co. had borrowed 200 shares of Crucible Steel from some broker and loaned 100 shares of Union Pacific to another broker, the 200 Crucible would appear with stocks to receive on the left side of the clearance sheet, and the 100 Union Pacific on its right side, with stocks to deliver. The money equivalents or cash extensions of these items would appear after them on the sheet, just as with stocks bought or sold.

Exchange tickets are exchanged for such loans of stock just as in the case of sales of stock. Even though such loaned or borrowed stocks create a stock balance to receive or to deliver which is settled at clearing house prices, the broker's check or draft automatically adjusts any inequalities in money arising between the actual price at which the money loan was made, and the delivery price. Indeed, for all we can tell, some of the stocks to deliver on Jenkins & Co.'s sheet may really be loans of stock and some of its stocks to receive may be borrowings of stock. Similarly, cleared stocks which have been borrowed are afterwards returned through the stock clearance system; in addition the account of a customer may be transferred through it from one Stock Exchange firm to another.

**Economies Obtained by the System.**—The tremendous saving in time, labor, and money effected by the clearance of stocks can be illustrated in no more concrete way than by reference to just such a clearance sheet as the above. On the given day the firm has bought 2,100 shares for \$209,362.50 from eleven different firms, and sold 2,200 shares for \$235,-

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<sup>18</sup> See Chapter VII, p. 187.

587.50 to eight other firms. Before the institution of the clearance system it would have required trips to nine separate offices, the receiving of eleven deliveries, the handling of 4,300 shares of stock, and the employment of \$444,950 of bank credit to settle these contracts. But under the system of security clearance in the Night Branch, of which the clearance sheet is the record (and without consideration of the further economies effected by the Day Branch of the Stock Clearing Corporation), Jenkins & Co. can settle the day's business by paying \$21,000 and getting 200 Reading, by receiving \$45,000 and delivering 300 Steel, and by drawing a draft against the clearing house for \$2,225.



Figure 29. Night Clearing Branch Draft

**Delivery of the Clearance Sheet.**—Let us see by what operations the Night Branch is able to bring about these huge economies. Jenkins & Co. preserves a record of the various items on its clearance sheet on what is known as its “clearing house blotter,”<sup>19</sup> along with interest charges and other items of value to the firm but not to the Stock Clearing Corporation. The clearance sheet itself, which constitutes legal proof of delivery, is sent to the Night Branch that evening. The Stock Clearing Corporation retains these clearance sheets for a period of about ten years. The rule is that before 7 P.M. on the day when the above transactions are made, Jenkins & Co. must deliver its clearance sheet to the Night Branch of the Corpora-

<sup>19</sup> See Chapter XV, p. 418.



tion. With it is sent the firm's draft for \$2,225 (Figure 29) which, as we have seen, is needed to balance the cash side of the day's business.

As shown in the illustration, this draft is drawn by Jenkins & Co. against the account of the Stock Clearing Corporation in the Bank of the Manhattan Trust Co. After all the items on the firm's clearance sheet have been audited and found correct, the manager of the corporation will sign his name under the word "Approved" in the lower left-hand corner of the draft. Jenkins & Co. will get the draft back the next morning and deposit it in its own bank to its account. Later on, in the regular course of events, the proceeds of such drafts are collected through the Bank Clearing House.

#### **The Accompanying Exchange and Balance Tickets.—**

With its clearance sheet Jenkins & Co. also sends the eleven red and white "deliver exchange" tickets of the eleven houses which have sold stock to Jenkins & Co. that day. These tickets have come to Jenkins & Co., as we have seen, through the Distributing Department of the Night Branch, and serve to establish the accuracy of the items on the "receive" side of Jenkins & Co.'s clearance sheet, since they have all originated with the firms which have sold or loaned stock to Jenkins & Co. Likewise, the latter firm sends with its clearance sheet all the black and yellow "receive exchange" tickets of the eight firms to which Jenkins & Co. has sold or loaned stock that day. These tickets have also come to Jenkins & Co. through the Distributing Department, and, since they have originated with these various buying or borrowing firms, serve to establish the accuracy of the items on the "deliver" side of Jenkins & Co.'s clearance sheet. Meanwhile, of course, Jenkins & Co.'s red and white "deliver exchange" tickets are being similarly sent in with the clearance sheets of Wilkins & Co. and the other firms which have bought or borrowed stock that day of Jenkins & Co., and the latter's black and yellow "receive exchange" tickets with the clearance sheets of Jefferson & Co. and the

other firms which have sold or loaned stock to Jenkins & Co. the same day.

In addition, Jenkins & Co. makes out and sends to the Stock Clearing Corporation its balance tickets. These consist of two

| STOCK CLEARING CORPORATION (NIGHT CLEARING BRANCH)                                               |             |                        |         |
|--------------------------------------------------------------------------------------------------|-------------|------------------------|---------|
| THE UNDERSIGNED WILL <b>DELIVER</b> THE FOLLOWING <b>BALANCE</b> OF STOCK AT THE DELIVERY PRICE. |             |                        |         |
| SHARES                                                                                           | STOCK       | DELIVER TO             |         |
| 300                                                                                              | U. S. Steel | Arnold, Mitchell & Co. | 300     |
|                                                                                                  | common      |                        |         |
|                                                                                                  | 150         |                        |         |
|                                                                                                  |             |                        |         |
|                                                                                                  |             |                        |         |
| DATE 7/1/29                                                                                      |             | NAME Jenkins & Co.     | No. 400 |

Figure 30. Deliver Balance Ticket

| STOCK CLEARING CORPORATION (NIGHT CLEARING BRANCH)                                               |         |                    |         |
|--------------------------------------------------------------------------------------------------|---------|--------------------|---------|
| THE UNDERSIGNED WILL <b>RECEIVE</b> THE FOLLOWING <b>BALANCE</b> OF STOCK AT THE DELIVERY PRICE. |         |                    |         |
| SHARES                                                                                           | STOCK   | RECEIVE FROM       |         |
| 200                                                                                              | Reading | T. Long & Co.      | 200     |
|                                                                                                  | 105     |                    |         |
|                                                                                                  |         |                    |         |
|                                                                                                  |         |                    |         |
|                                                                                                  |         |                    |         |
| DATE 7/1/29                                                                                      |         | NAME Jenkins & Co. | No. 400 |

Figure 31. Receive Balance Ticket

special forms, one of which (Figure 30) records the balances of stock the firm has to deliver, and the other of which (Figure 31) records the balances of stock the firm has to receive. In both cases separate balance tickets are made out for each separate stock balance. In this case, Jenkins & Co. makes out

one deliver balance ticket for 300 Steel, and one receive balance ticket for 200 Reading.

**Final Delivery of Clearing Member's Sheet and Tickets.**

—It is a rule of the Stock Clearing Corporation that all these clearance sheets, deliver and receive tickets, and statements of balances of stocks to receive or to deliver, as well as each firm's check or its draft on the Corporation, must be turned in by the clearing member at the Night Branch by 7 P.M. This rule is sometimes relaxed by the Corporation during large markets, when the preparation of clearance sheets takes more time than usual. But if there has been a delay which in the judgment of the Corporation is unreasonable, the offending firm is subject to fine. Fines are also imposed by the Corporation for clerical errors or omissions in either tickets or clearance sheets. The neglect or failure of a member or firm to exchange tickets, in the manner described above, constitutes a default in delivery.

**Headquarters of the Night Branch.**—Thus far the chief stage setting of our typical daily clearance has been the brokerage office of Jenkins & Co. at 500 Wall Street. But after the clearance sheet, with the appropriate check or draft, tickets, and statements, has been prepared and sent to the Stock Clearing Corporation, the part played by the brokerage office in the clearance is over for the day, and the scene shifts to the Night Branch of the Stock Clearing Corporation at 55 New Street.

The back wall of the Night Branch main room is penetrated by four small windows, not unlike those of a ticket office, through which brokers' clerks deliver the clearance sheets, etc., already described. In the Night Branch an official is constantly in attendance, day and night, to answer questions, settle disputes, etc. During the day a special day force is employed to run down and eliminate errors, etc., in the previous clearance. But by 7 P.M. a much larger force of clerks arrives and their primarily nocturnal labors begin.

The room is filled with wide tables where the clerical work connected with the clearance is done, and at 7 P.M. the clerks are usually in their places working on the clearance sheets which have already arrived. The whole work must be completed each night, and thus the volume of sales that day, as well as the errors which may have crept into the auditing of them, determines the hour, whether 10 P.M. or far later into the night, at which the clerks can go home. A corps of special clerks is kept in reserve, to run down and eliminate any errors which may be made in the clearance. Of course, the fact that a final balance is obtained is practically proof that the clearance has been made without error.

**Separation and Distribution of the Tickets.**—The clearance sheet of each clearing member, which by 7 P.M. is delivered by his messenger through one of the windows in the back of the Night Branch office is, as we have seen, accompanied by a receive or a deliver ticket of another firm for each item on the sheet, the statements of stock balances to receive and deliver, and a check or draft, as the case may require. Clerks at these windows first separate the clearance sheets from the accompanying tickets and credit instruments. The exchange receive and deliver tickets are distributed in the respective boxes of the firms whence they have originated. For example, Wilkins' receive ticket for 100 Steel, which comes in attached to Jenkins' sheet, is detached and placed in Wilkins' box; and Jenkins' deliver ticket for the same stock, attached to Wilkins' sheet, is detached and placed in Jenkins' box.

Next, the stock balance tickets to receive and to deliver which accompany each sheet are checked by a teller against the balance items as they appear on the sheet, and are then turned over to another set of clerks who place each one with the particular allotment sheet (whose function will be considered presently) for the stock in which it is made out. For example, Jenkins & Co.'s two stock balance tickets for the balance of 300 Steel to deliver and the balance of 200 Reading to receive,

are separated from the clearance sheet and placed with the allotment sheets for Steel and for Reading. Finally, the checks or drafts which are delivered at the windows with the clearance sheets are sent to a separate department.

**Examination and Checking of the Clearance Sheet.—**

After being divested of the accompanying exchange and balance tickets, checks, and drafts, the clearance sheets are taken in charge by the examiner, who inspects their delivery prices, the cash extensions, and the totals of the stock items. If a sheet is incorrect in any respect, the error is run down and eliminated without delay; if correct, the clearance sheet receives the mark of the examiner after the "EX" at its top and then passes onward to the checker.

Meanwhile, all the exchange tickets which came in the four windows with the sheets of other firms have been resorted and placed in the boxes of the firms whence they have originated. Thus, when Jenkins & Co.'s clearance sheet passes from the examiner to the checker, the latter can obtain the exchange tickets sent out that day by Jenkins & Co. These tickets the checker uses to check against the items on the clearance sheet. Actually, it is only necessary to check the delivery side of the sheet against its appropriate deliver tickets. For example, the checker obtains Jenkins' deliver ticket for 100 Steel from Jenkins' box, where it has been placed after being detached from Wilkins' sheet, and checks it against the item on the sheet. So it is, too, with all the other deliver tickets which have originated with Jenkins & Co. In this way each deliver item on every clearance sheet is checked against the appropriate deliver exchange ticket, and another opportunity to detect any errors or omissions in the sheet is thus obtained. When the checker finishes with each clearance sheet he indicates the fact by leaving his mark after the "CK" at its top. The termination of checking the sheet marks the point at which the settlement of the intermediate contracts which it records is effected. In Jenkins & Co.'s sheet, for example, the intermediate contracts



for 600 Rubber, 800 Reading, and 500 Steel are thus settled and cleared.

**Handling of Checks and Drafts.**—Meanwhile, in another department the checks turned in with the clearance sheets are added up in a summarized statement. The same is done with the drafts on the Stock Clearing Corporation. The total amount of checks should, of course, always exactly equal the total amount of the drafts. If these totals do not prove by thus balancing each other, it is apparent that an error has been made somewhere, and the clerical force is at once set to work to hunt it down and eliminate it. Fines are levied by the Stock Clearing Corporation upon such clearing members as are guilty of errors or omissions in the preparation of their sheets, tickets, statements, drafts, or checks.

**The Allotment Sheet.**—We must now see how it is that the Night Branch directs the delivery of stock balances. It will be recalled that when each clearing member's clearance sheet comes in at the windows, the statements of stock balances to receive and to deliver are detached from it and distributed among the allotment sheets. Every stock which is cleared has its particular allotment sheet; active stocks each have one or more whole sheets, while several only fairly active stocks may be recorded on one sheet.

In order to pursue further the sale made by Jenkins to Wilkins, the accompanying illustration of an allotment sheet (Figure 32) has been made out for Steel—the stock in which their bargain has occurred. Since there must always be two parties to every sale—a purchaser and a seller—it necessarily follows that for every 100 shares of stock to be delivered there must be an equal amount of the same stock to be received. Consequently, the total of the stock balances of Steel to be received (recorded on the left side of the allotment sheet) must always exactly equal the total of the stock balances of Steel to be delivered (recorded on its right side). It is, therefore,

easy to find a buying firm or firms to which the stock balances of each selling firm can be delivered. Thus the allotment clerk directs our friends, Jenkins & Co., with a balance of 300 shares, to deliver them to Arnold, Mitchell & Co., who have to receive just that amount. Similarly, he directs Le Mar, Burke & Co. to deliver 200 shares to Whiting, Todd & Co.; D. S. Cooke & Co. to deliver 100 shares to E. A. Wilson &

| U. S. Steel common                    |                                   |   |                   |   |   |  |        |                                     |  |
|---------------------------------------|-----------------------------------|---|-------------------|---|---|--|--------|-------------------------------------|--|
| SECURITY BALANCES                     |                                   |   |                   |   |   |  |        |                                     |  |
| DATE <i>July 1<sup>st</sup>, 1929</i> |                                   |   |                   |   |   |  |        |                                     |  |
| SHARES                                | RECEIVE                           | ✓ | ALLOTMENT NUMBERS |   |   |  | SHARES | DELIVER                             |  |
| 400                                   | <i>L. A. Smith &amp; Co.</i>      | ✓ | 1                 | 6 |   |  | 300    | <i>Jenkins &amp; Co.</i>            |  |
| 200                                   | <i>Whiting, Todd &amp; Co.</i>    | ✓ | 2                 | 2 |   |  | 200    | <i>Le Mar, Burke &amp; Co.</i>      |  |
| 100                                   | <i>E. A. Wilson &amp; Co.</i>     | ✓ | 3                 | 3 |   |  | 100    | <i>D. S. Cooke &amp; Co.</i>        |  |
| 200                                   | <i>Lee, Tuttle &amp; Co.</i>      | ✓ | 4                 | 4 | 5 |  | 300    | <i>B. P. Robinson &amp; Co.</i>     |  |
| 100                                   | <i>Wilkins &amp; Co.</i>          | ✓ | 5                 | 1 |   |  | 300    | <i>Fisher, Carrington &amp; Co.</i> |  |
| 300                                   | <i>Arnold, Mitchell &amp; Co.</i> | ✓ | 6                 | 1 |   |  | 100    | <i>C. W. Green &amp; Co.</i>        |  |
|                                       |                                   |   | 7                 |   |   |  |        |                                     |  |
|                                       |                                   |   | 8                 |   |   |  |        |                                     |  |
| 1,300                                 |                                   |   | 9                 |   |   |  | 1,300  |                                     |  |
|                                       |                                   |   | 10                |   |   |  |        |                                     |  |
|                                       |                                   |   | 11                |   |   |  |        |                                     |  |
|                                       |                                   |   | 47                |   |   |  |        |                                     |  |
|                                       |                                   |   | 48                |   |   |  |        |                                     |  |
|                                       |                                   |   | 49                |   |   |  |        |                                     |  |
|                                       |                                   |   | 50                |   |   |  |        |                                     |  |

Figure 32. Allotment Sheet

Co.; B. P. Robinson & Co. to deliver 200 shares to Lee, Tuttle & Co. and 100 shares to Wilkins & Co.; and Fisher, Carrington & Co. to deliver its 300 shares, and C. W. Green & Co. its 100 shares, to L. A. Smith & Co.

Recently, in order to save time, the practice was inaugurated of referring to clearing members on the clearance sheet by numbers rather than by names. But the names have been retained on examples used in this book, in order to render the clearing process less confusing to the reader.

**"Giving a Name."**—At the completion of this simple process of allotting deliverable stocks to firms who have stocks to receive, it only remains for the Night Branch clerks to fill in the blanks on the statements of stock balances to receive and to deliver. We have seen that Jenkins & Co. turned in with its clearance sheet one statement that it had 200 shares of Reading to receive, and another that it had 300 shares of Steel to deliver. Since Jenkins & Co. could not tell to what firm the allotment clerk would direct it to deliver the stock balance in Steel, or from what firm to receive the stock balance in Reading, it put only its own name on the two statements. We have seen how all the stock balances in Steel for that day have been allotted. A similar process of allotment has meanwhile been completed in Reading. The clerk has only to place on Jenkins & Co.'s statement of stock to deliver the name of Arnold, Mitchell & Co. under the "Deliver to" column, and on its statement of stock to receive, the name of some firm determined by the clerk of the Reading allotment sheet—say, T. Long & Co.—under the "Receive from" column. At this point the statement becomes an order.

**Conclusion of the Night Clearance.**—When all stock balances have been allotted and all the statements of stock balances to receive and deliver have been "given a name" in the manner described above, that evening's clearance is completed and the clerks can start homeward through the dark and deserted canyons of the Wall Street district.

The next morning at 9 A.M. the messenger of each clearing member calls at the Night Branch and is given back through the windows his firm's statements of stock balances to receive and to deliver, with the names of the firms from whom it has to receive and to whom it has to deliver the stock balances, before 2:15 P.M. that day.

**Machine Clearance.**—After months of preliminary testing, on June 3, 1930, the Stock Clearing Corporation inaugurated a new practice of compiling clearing sheets for its members by

machine, instead of requiring members to make out and submit to it clearing sheets made out by hand. The new practice was at first confined to cleared bonds. The plan provides that after the members complete the exchange of their cleared bond exchange tickets, the latter be delivered to the Night Clearing Branch. Here the written data on each ticket respecting deliverer and receiver, the name, price and amount of the security, etc., is translated—so to speak—into holes punched on special cards. These can be rapidly sorted by machine, and from them other machines can print each member firm's clearing sheet.

Thus the great amount of detailed clerical work required by the preparation of clearing sheets, which formerly had to be done by clerks of the member firms, may be performed centrally by machines in the Stock Clearing Corporation. The machine clearance of bonds has proved so successful that at this writing it is definitely planned to experiment with the larger problem of machine stock clearance. If this proves similarly successful, all cleared securities may in the future be handled in this way, and in consequence present practices with members' clearing sheets as above described may to that extent be changed.

**Depositing Checks and Approving Drafts.**—Meanwhile the department of the Night Branch that supervises the checks and drafts sent to it, makes out a summarized deposit slip for all checks received the previous evening. Certification is obtained on all checks over \$5,000 and the entire number of checks is then deposited in the Bank of the Manhattan Trust Co. The accuracy of all drafts against the Night Branch of the Stock Clearing Corporation, which have been also turned in the previous evening by clearing members, is proved. As stated, the total amount of the drafts must exactly equal the total amount of the checks.

It only remains for the manager of the Night Branch to approve the drafts by signing them in the space on the left-

hand side provided for that purpose, and at 12 M. they are given out to messengers of the clearing firms, who call for them. The firms deposit the drafts to their own accounts in their banks, who collect the proceeds from the Bank of the Manhattan Trust Co. through the Bank Clearing House. Thus all the funds deposited in this bank on a given day's clearance by the Night Branch are withdrawn by these drafts for the same day. After this the work of the Night Branch is concerned only with fines, statistics, perhaps special clearances, and other miscellaneous tasks until late in the afternoon when the current day's clearance begins to demand another repetition of the Branch's swift and efficient routine.

Thus the effect of the Night Branch clearance is to obviate the delivery of securities and payment therefor on all intermediate contracts in cleared securities, to mark all balance contracts to a single settlement or delivery price for each issue, to adjust by check and draft the money difference between security values at these settlement prices and at their actual contract prices, and finally to give direction to the security deliveries to be made between deliverers and receivers. Thus the two first stages of the entire process—namely, comparison and security clearance—are concluded; methods of actual security delivery will be related in the next chapter, and the two final stages of money clearance and settlement in Chapter XIV.

**Benefits of the Night Branch Clearance.**—Although the operations of the Night Branch constitute today only a part of the entire work of the Stock Clearing Corporation, nevertheless before continuing into its other functions it would be well to note in just what the benefits of Night Branch operations consist.

Most important has been the enormous saving effected in the amount of banking accommodation required to settle Stock Exchange contracts each day. Statistics compiled over a period of years show that about 90% of the total reported sales of shares on the Stock Exchange have been cleared, and of this



amount cleared about 50% represented intermediate contracts which (under the old "Clearing House of the New York Stock Exchange" or the present Night Branch) could be cleared without the need of banking accommodation. Since the banking accommodation needed by Stock Exchange members to settle their daily purchases and sales is in practice obtained by them on unsecured "day loans" at the banks, the operations of the security clearance system have greatly reduced the amount of these day loans regularly required, and therefore the amount of certified checks in which the day loans were employed by the brokers.

Secondly, the security clearance system has effected a vast saving of time, not only through its settlement of intermediate contracts but also in the direction which it has given to the deliveries of stock balances, and the simplification it has produced in money payments through its use of "settlement" or "delivery" prices. In the large stock markets since 1900, it would have been impossible without the security clearance system to have maintained the "daily settlement system" on the New York Stock Exchange, whereby deliveries are to be completed by 2:15 the first full business day after the date of contract. Stock clearance has prevented breakdowns in the stock market, just as bank clearance has prevented breakdowns in the money market.

A third service rendered by security clearance is the huge economies it has effected in labor. Indeed, the whole process of clearing and settling security contracts is from one standpoint simply a great labor-saving device, as Stock Exchange members would instantly appreciate were the Night Branch operations suddenly suspended. As in other branches of American business, the security market has been able to pay its employees more because it has as far as possible eliminated the purely mechanical tasks which do not require special intelligence and aptitude—such as messenger service and routine clerical work. In addition, the security clearing system per-

forms certain tasks for its members which they could not perform individually for themselves; an example is the central audit which it makes of all business in cleared securities each day, without which the bookkeeping and clerical work in Stock Exchange member offices would be much greater than it actually is.

Thus, a greater safety is imparted to the whole stock market by the speedy detection of clerical errors, and by the insistence upon promptness and accuracy, the inviolacy of Stock Exchange contracts made in cleared securities is greatly enhanced.

#### **Flexibility of the Night Branch Security Clearance.—**

The system of security clearance administered by the Night Branch seems capable of handling without undue strain the heaviest volume of transactions which occur on the Stock Exchange. The largest single day's trading to date occurred on October 29, 1929, when 16,400,000 shares were reported sold.

Owing to inevitable delays, the clearance on this vast mass of stock contracts was concluded the next day, with the following record figures:

|                                                     |                 |
|-----------------------------------------------------|-----------------|
| Shares cleared both sides, including balances.....  | 46,252,400      |
| Total value both sides, contracts and balances..... | \$2,436,626,000 |
| Share balances one side.....                        | 8,887,000       |
| Value share balances one side.....                  | \$ 460,763,400  |
| Cash balances one side.....                         | \$ 11,823,100   |
| Number of parties clearing.....                     | 399             |
| Bank certification obviated.....                    | \$ 757,549,600  |

**Inviolacy of Contracts.**—This process of clearing and settling intermediate contracts which the Night Branch performs as an agent for its members has sometimes bewildered writers and commentators upon finance, since it cannot be visualized as readily as direct deliveries and payments. Occasionally, indeed, the perennial critics of everything financial have declared that such cleared contracts were illegal because

they did not result in such direct deliveries of securities and payments of money. Even in the narrower and legal aspect of the matter, however, the courts have held that contracts which show an intent to deliver are legal. That cleared contracts in Stock Exchange securities show such an intent to deliver is at once obvious to anyone who will read a typical clearance sheet with its exchange deliver and receive tickets. An authority in economic matters has said:<sup>20</sup>

There is no such thing known on any of the reputable exchanges as a contract under which delivery is waived: one obstacle to an understanding of this lies in the way in which transactions are cleared through the Clearing House; but an attempt to prove the legitimacy of the method of clearing would be useless to one who does not understand the way in which bank transactions, for instance, are cleared. It is as ridiculous to say that the clearing of many contracts for delivery on the Stock Exchange, and the settlement of these transactions by a payment of balances, both of stocks and cash, indicates that such transactions are not of a perfectly genuine nature as it is to assert that because the Clearing House for the New York banks arranges for an offset of checks and the payment of only a small balance of cash, therefore, the banking business in New York is not concerned with legitimate business. Speculation could continue without a Clearing House, and in fact, the New York Stock Exchange was very late in adopting this device. Nothing as to the legitimacy or illegitimacy of transactions can be determined from the mere adoption of an up-to-date business method.

The clearance of security contracts must, therefore, be looked upon as one of the great financial developments of the past century, effecting as it does an economy of time, labor, and capital in the major market places of the modern world. For all its technical terminology and its clerical detail, it is based on the simplest common-sense principles. Without the employment of these principles by the banks and the security and wholesale commodity markets, the conduct of modern production and distribution with the present ease, safety, and

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<sup>20</sup> H. C. Emery, "Should Speculation be Regulated by Law?" in *Journal of Accountancy*, April, 1908.

efficiency would be an utter impossibility. The Congress in Washington wisely recognized the usefulness and legitimacy of centralized clearing and settling methods by giving legislative approval to the Gold Settlement Fund as an integral operating feature in the Federal Reserve system.

## CHAPTER XIII

### SECURITY DELIVERIES, LOANS, AND TRANSFERS

In the previous chapter it was pointed out that the whole process of security clearance and settlement involved five essential stages. The first two of these—comparison and security clearance—have already been described in Chapter XII, while the last two—money clearance and money settlement—remain to be dealt with in the next chapter. The present chapter will be devoted to the third stage—that of security deliveries and security loan handling, as well as to the Transfer Department of the Stock Clearing Corporation.

**Former Methods of Making Security Deliveries.**—By rule of the Stock Exchange, the security deliveries called for by “regular way” purchase and sales contracts on the Exchange, must be made on the next full business day following the date of contract. In consequence, Stock Exchange firms deliver and receive securities in the daily settlement from about 10 A.M. to 2:15 P.M. each full business day.

Until the recent inauguration of centralized security deliveries, of which more anon, it was the immemorial practice in Wall Street for each Stock Exchange firm which was a seller or lender to make deliveries of the securities direct to the office of the buyer or borrower who had these particular securities to receive.<sup>1</sup> Originally the deliverer’s messenger was given in exchange a check in payment by the buyer; after the establishment of the Day Branch of the Stock Clearing Corporation in 1920, the deliverer’s messenger obtained, instead of a money check, a special receipt on what is known as the “delivery

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<sup>1</sup> See Appendix XIIa.



ticket," which later served to credit the account of the delivering firm, and debit the account of the receiving firm, in the Day Branch of the Stock Clearing Corporation. As deliveries of all stocks and of cleared bonds are now made through the new Central Delivery Department, "delivery tickets," as described below, are today employed only for non-cleared bonds, and their use has consequently shrunk to only minor importance.

**The Delivery Tickets.**—Since the Stock Clearing Corporation is merely the agent of its members in effecting settlements of their accounts with each other, it obtains specific orders from them for every item which is credited or charged to their money-accounts at the Day Branch.<sup>2</sup> In the case of security deliveries which have been made direct between brokers' offices rather than through the Central Delivery Department, such orders are given to the Stock Clearing Corporation by means of the "delivery tickets"; also, as we shall presently see, the "delivery tickets" establish the fact that delivery of the securities has been made—an essential matter, since no Exchange member will want to pay for securities until he has received them.

The "delivery ticket" is of buff paper and is divided into mainly similar parts—a "credit ticket" (Figure 33) printed in red, and folding under it a "charge ticket" (Figure 34) printed in black; each part is provided with a detachable stub. At this writing all cleared securities are handled through the Central Delivery Department and hence the "delivery tickets" are not used for them, and only with non-cleared securities which are still delivered direct between offices. The "delivery ticket" identifies the security to be delivered by name, amount, price, and value, and also specifies the names of the delivering and receiving firms. The deliverer of securities makes out both the "credit" and "charge" tickets at once (except, of course, for the signature of the receiving member) by placing

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<sup>2</sup> See Chapter XIV, p. 401.

04B-1237-2024

**FOR BOND DELIVERIES ONLY**  
**CREDIT TICKET** Blotter Line No. 7  
 (Name and Clearing Number of Delivering Member) 400  
Jenkins & Co.

**FOR BOND DELIVERIES ONLY**  
**DELIVERY TICKET** Blotter Line No. 24  
 (Name and Clearing Number of Delivering Member) 400  
Jenkins & Co.

**STOCK CLEARING CORPORATION**  
 (DAY BRANCH)  
 New York, July 2nd 1929

| Delivered to                     | Bonds    | Security             | Price          | Value          |
|----------------------------------|----------|----------------------|----------------|----------------|
| <u>24</u> <u>Brown &amp; Co.</u> | <u>4</u> | <u>French 7 1/2s</u> | <u>121 3/8</u> | <u>4855.00</u> |

Credit the value of the above Security to the account of  
Jenkins & Co.

Received by the undersigned WITH APPROVAL OF STOCK CLEARING CORPORATION,  
 subject to its rules.

Total Delivery \_\_\_\_\_  
 Delivered \_\_\_\_\_  
 Bal. to Deliver \_\_\_\_\_

Time Stamp with Name and Clearing Number  
Jenkins & Co.  
 Time Rec. by S.C.C. \_\_\_\_\_

Do not use CARBON ON THIS STUB  
 as name and number will conflict.

**RECEIVED**  
 STOCK CLEARING CORPORATION  
 July 2nd, 1929  
 12:10 P.M.

**RECEIVED**  
 BROWN & CO.  
 July 2nd, 1929  
 12:10 P.M.

Brown & Co. 452  
 (Signature of Receiving Member)

Figure 33. Delivery Credit Ticket

| FOR BOND DELIVERIES ONLY                                                                                                                                                                                                                   |             |       |            | CHARGE TICKET                                                                               |          |                                                                                                                                                                                                                                                       |  | Blotter Line No. <u>7</u><br>(Receiving Member)                                                                                                   |  |                                                                    |  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------|------------|---------------------------------------------------------------------------------------------|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|---------------------------------------------------------------------------------------------------------------------------------------------------|--|--------------------------------------------------------------------|--|
| <u>Jenkins &amp; Co</u> 400<br><small>(Name and Clearing Number of Delivering Member)</small>                                                                                                                                              |             |       |            | <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)<br>New York, <u>July 2nd</u> 192 <u>9</u> |          |                                                                                                                                                                                                                                                       |  | <b>FOR BOND DELIVERIES ONLY</b><br><u>Jenkins &amp; Co</u><br><small>(Name of Delivering Member)</small>                                          |  |                                                                    |  |
| Blotter Line No. Delivering Member                                                                                                                                                                                                         | Received by | Bonds | Security   | Price                                                                                       | Value    |                                                                                                                                                                                                                                                       |  |                                                                                                                                                   |  |                                                                    |  |
| 24                                                                                                                                                                                                                                         | Brown & Co  | 4     | Frank 71.5 | 121 3/8                                                                                     | 4 855.00 |                                                                                                                                                                                                                                                       |  |                                                                                                                                                   |  |                                                                    |  |
| Charge the value of the above Security to the account of <u>Brown &amp; Co</u>                                                                                                                                                             |             |       |            |                                                                                             |          |                                                                                                                                                                                                                                                       |  |                                                                                                                                                   |  | Blotter Line No. <u>24</u><br><small>(Delivering Member)</small>   |  |
| Received by the undersigned WITH APPROVAL of STOCK CLEARING CORPORATION,<br>subject to its rules.                                                                                                                                          |             |       |            |                                                                                             |          |                                                                                                                                                                                                                                                       |  |                                                                                                                                                   |  | <u>Brown &amp; Co</u><br><small>(Name of Receiving Member)</small> |  |
| Total Delivery _____<br>Delivered _____<br>Bal. to Deliver _____                                                                                                                                                                           |             |       |            |                                                                                             |          | Time Received _____<br>(Time Stamp with Name and Clearing Number)                                                                                                                                                                                     |  | Time Received _____                                                                                                                               |  |                                                                    |  |
| <div style="border: 1px solid black; border-radius: 50%; padding: 10px; width: fit-content; margin: 0 auto;"> <b>RECEIVED</b><br/> <b>BROWN &amp; CO.</b><br/>           July 2nd, 1929<br/>           12<sup>10</sup> P.M.         </div> |             |       |            |                                                                                             |          | <div style="border: 1px solid black; border-radius: 50%; padding: 10px; width: fit-content; margin: 0 auto;"> <b>RECEIVED</b><br/> <b>STOCK CLEARING CORPORATION</b><br/>           July 2nd, 1929<br/>           12<sup>15</sup> P.M.         </div> |  | Received _____<br><small>for verification, the securities described in the Charge Ticket must be placed in the above Blotter line number.</small> |  |                                                                    |  |
| <u>Brown &amp; Co</u> 452<br><small>(Signature of Receiving Member)</small>                                                                                                                                                                |             |       |            |                                                                                             |          |                                                                                                                                                                                                                                                       |  |                                                                                                                                                   |  |                                                                    |  |

Figure 34. Delivery Charge Ticket

a carbon sheet between them; thus time is saved and the possibility of discrepancies between the two forms is eliminated.

Before the establishment of the Central Delivery Department, it was the custom for the delivering firm to send one of its messengers to the office of the receiving firm, with every actual security certificate to be delivered and the "delivery ticket" which in each case pertained to it. When the deliverer's messenger delivered the securities to the receiver in the latter's office, the receiver would then sign both "credit" and "charge" forms of each "delivery ticket," and return them to the messenger. When signed by the receiver in this way, the ticket constituted evidence that the securities had been delivered, and also orders on the Stock Clearing Corporation to charge the account of the receiver, and credit the account of the deliverer, for the money value of the delivered securities. In order to establish such debits and credits in the Day Branch accounts, the deliverer's messenger would take the delivery tickets, when duly signed by the receiving firm, to the Day Branch headquarters and pass them through a window to its Receiving Ticket Department. The latter would place a time stamp on the ticket, tear off the stub of the "credit ticket" and give it to the deliverer's messenger as evidence that he had delivered the ticket to the Stock Clearing Corporation. The way the Stock Clearing Corporation subsequently employed "delivery" tickets to establish actual debits and credits on its clearing members' accounts, will be described in the next chapter.<sup>3</sup>

**Centralization of Security Deliveries.**—With the continual growth of the New York stock market, it became more and more obviously advantageous to centralize security deliveries of Stock Exchange members through a common delivery office in the Stock Exchange, after the long-established practice in the *salle de compensation* of the Paris Bourse and the *Giro-Verkehr* of the Bank des Berliner Kassen-Vereins abroad.<sup>4</sup>

<sup>3</sup> See Chapter XIV, p. 391.

<sup>4</sup> See Appendix XIIIa.

Accordingly in 1929, a Central Delivery Department was established in the Stock Clearing Corporation headquarters in the ground floor of the Stock Exchange building, beside the older Day Branch offices there. The functions of this Central Delivery Department in general resemble those of the Night Branch Distributing Department, except that the Central Delivery Department handles actual security certificates and the

| CHARGE TICKET                                                                                                            |                  |                                           |            |               |
|--------------------------------------------------------------------------------------------------------------------------|------------------|-------------------------------------------|------------|---------------|
| Delivery Between Members, Through Central Delivery Department                                                            |                  |                                           |            |               |
| <b>Jenkins &amp; Co. 400</b><br>Name and Clearing Number of Delivering Member                                            |                  |                                           |            |               |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY BRANCH)                                                                        |                  |                                           |            |               |
| New York <b>July 2nd.</b> 19 <b>29</b>                                                                                   |                  |                                           |            |               |
| NAME OF RECEIVING MEMBER                                                                                                 | Shares<br>Number | Security                                  | Price      | Value         |
| <b>Arnold Mitchell &amp; Co.</b>                                                                                         | <b>300</b>       | <b>U. S. Steel com.</b>                   | <b>150</b> | <b>45 000</b> |
| On Stock Clearing Corporation Security Balance Order<br>Delivered subject to the Rules of the Stock Clearing Corporation |                  |                                           |            |               |
| Total Delivery <u>✓</u>                                                                                                  |                  |                                           |            |               |
| Delivered _____                                                                                                          |                  |                                           |            |               |
| Bal. to Deliver _____                                                                                                    |                  |                                           |            |               |
| <b>1</b>                                                                                                                 |                  | Charge to the Account of Receiving Member |            |               |

Figure 35a. Charge Ticket—form sent to receiver's cage in Day Branch, S. C. C.

tickets pertaining to them, instead of merely exchange and comparison tickets and sales memoranda.

When a clearing member delivers securities through the Central Delivery Department, he attaches to each security delivery (which may of course consist of more than one security certificate) a special "charge ticket" for delivery between members through that Department (Figure 35). This ticket is inscribed with the name and clearing number of the delivering member, the date, the name of the receiving member, the amount and identity of the securities delivered, their price, and



| CHARGE TICKET                                                                                                           |                        |                        |            |                 |
|-------------------------------------------------------------------------------------------------------------------------|------------------------|------------------------|------------|-----------------|
| Delivery Between Members, Through Central Delivery Department                                                           |                        |                        |            |                 |
| Name and Clearing Number of Delivering Member<br><i>Jenkins &amp; Co 400</i>                                            |                        |                        |            |                 |
| STOCK CLEARING CORPORATION                                                                                              |                        |                        |            |                 |
| New York <i>July 2nd</i> 1929                                                                                           |                        |                        |            |                 |
| NAME OF RECEIVING MEMBER                                                                                                | Shares<br><i>Round</i> | Security               | Price      | Value           |
| <i>Arnold Mitchell &amp; Co</i>                                                                                         | <i>300</i>             | <i>U.S. Steel com.</i> | <i>150</i> | <i>45,000 -</i> |
| On Stock Clearing Corporation Security Balance Order<br>Received subject to the Rules of the Stock Clearing Corporation |                        |                        |            |                 |
| Total Delivery <input checked="" type="checkbox"/>                                                                      |                        |                        |            |                 |
| Delivered _____                                                                                                         |                        |                        |            |                 |
| Bal. to Deliver _____                                                                                                   |                        |                        |            |                 |
| Received by the Undersigned                                                                                             |                        |                        |            |                 |
| Signature of Person Receiving Securities                                                                                |                        |                        |            |                 |

Figure 35b. Charge Ticket—form retained by Central Delivery Department, S. C. C.

| MEMORANDUM                                                                   |                        |                        |            |                 |
|------------------------------------------------------------------------------|------------------------|------------------------|------------|-----------------|
| Delivery Between Members, Through Central Delivery Department                |                        |                        |            |                 |
| Name and Clearing Number of Delivering Member<br><i>Jenkins &amp; Co 400</i> |                        |                        |            |                 |
| STOCK CLEARING CORPORATION                                                   |                        |                        |            |                 |
| (DAY BRANCH)                                                                 |                        |                        |            |                 |
| New York <i>July 2nd</i> 1929                                                |                        |                        |            |                 |
| NAME OF RECEIVING MEMBER                                                     | Shares<br><i>Round</i> | Security               | Price      | Value           |
| <i>Arnold Mitchell &amp; Co</i>                                              | <i>300</i>             | <i>U.S. Steel Com.</i> | <i>150</i> | <i>45,000 -</i> |
| Total Delivery <input checked="" type="checkbox"/>                           |                        |                        |            |                 |
| Delivered _____                                                              |                        |                        |            |                 |
| Bal. to Deliver _____                                                        |                        |                        |            |                 |
| This Ticket to be retained by Receiving Member as their record.              |                        |                        |            |                 |

Figure 35c. Charge Ticket—memorandum retained by receiving member

their value. This ticket is in triplicate; the uses of its three forms will be noted presently. With deliveries between members, a white "charge ticket" is used for cleared stocks and for bonds specially cleared, a buff ticket for non-cleared stocks, and a blue ticket for bonds regularly cleared; with deliveries to or from non-members, the charge ticket is yellow.

| STOCK CLEARING CORPORATION (DAY BRANCH)                                                                                 |                                 |                 |                        |                             |           |            |
|-------------------------------------------------------------------------------------------------------------------------|---------------------------------|-----------------|------------------------|-----------------------------|-----------|------------|
| Delivery Between Members Through Central Delivery Department                                                            |                                 |                 |                        |                             |           |            |
| Credit List for value of Security Balances Delivered as per Night Clearing Sheets Dated <u>July 2<sup>nd</sup></u> 1927 |                                 |                 |                        |                             |           |            |
| Collective Delivery—All Items on this List must be Delivered.                                                           |                                 |                 |                        |                             |           |            |
| No of List                                                                                                              |                                 |                 |                        |                             |           |            |
| <u>400</u> <u>Jenkins &amp; Co.</u>                                                                                     |                                 |                 |                        |                             |           |            |
| Name and Clearing Number of Delivering Member                                                                           |                                 |                 |                        |                             |           |            |
|                                                                                                                         | Deliver to                      | Shares<br>Bonds | Security               | Price                       | Value     |            |
| 1                                                                                                                       | <u>Arnold Mitchell &amp; Co</u> | <u>300</u>      | <u>U. S. Steel com</u> | <u>150</u>                  | <u>45</u> | <u>000</u> |
| 2                                                                                                                       |                                 |                 |                        |                             |           |            |
| 3                                                                                                                       |                                 |                 |                        |                             |           |            |
| 4                                                                                                                       |                                 |                 |                        |                             |           |            |
| 5                                                                                                                       |                                 |                 |                        |                             |           |            |
| 19                                                                                                                      |                                 |                 |                        |                             |           |            |
| 20                                                                                                                      |                                 |                 |                        |                             |           |            |
| Delivered subject to the By-Laws and Rules of Stock Clearing Corporation. Credit the Total Amount to our Account.       |                                 |                 |                        | Total Amount                | <u>45</u> | <u>000</u> |
| <u>Joseph H. Jenkins</u><br>Authorized Signature of Delivering Member                                                   |                                 |                 |                        | Added by <u>L. S.</u>       |           |            |
|                                                                                                                         |                                 |                 |                        | Re-added by <u>C. E. R.</u> |           |            |
|                                                                                                                         |                                 |                 |                        | Checked by <u>A. F. A.</u>  |           |            |

Figure 36. "Credit List," for delivery of securities between members through the Central Delivery Department

The delivering member also makes out a credit list (Figure 36), likewise in triplicate, which itemizes separately each security delivery to be made, stating in connection with each the clearing number of the receiving firm, the amount and identity

of the securities, their price, and their value. This list is not a "contingent credit" list since it is accompanied by the actual securities mentioned upon it, and since the total value of these securities will constitute an "actual" and not simply a "contingent" credit to the Day Branch account of the delivering member when the list and its securities are delivered by him to the Central Delivery Department of the Stock Clearing Corporation. With deliveries between members, a white credit list is used for cleared stocks and specially cleared bonds, a buff list printed in red for bonds regularly cleared, and a buff list printed in green for non-cleared stocks; with deliveries to or from non-members, the credit list is yellow.

Armed with this credit list and the appropriate security certificates and charge tickets, the messenger of the delivering firm goes to the Central Delivery Department offices. Its quarters are divided into an inner and an outer office; the substantial partition of stone and metal work which separates them consists of 10 receiving and 13 delivering windows which resemble tellers' windows in a bank. When the messenger of a Stock Exchange firm enters the outer office of the Central Delivery Department, he goes to the particular receiving window assigned to his firm according to its clearing house number. To the clerk at this window he delivers his credit list, together with the security certificates and charge tickets pertaining to the security deliveries listed upon it. The clerk checks each entry upon the itemized credit list against its accompanying security certificates and tickets, and if all is in order stamps the third form of the credit list and returns it as a receipt to the delivering member's messenger. As this third form specifically states, "The above securities have been received and verified as to count but not as to validity, transferability, or deliverability." Should objection to the securities in these latter particulars subsequently be raised by the receiving member, however, the latter can make reclamations or adjustments with the delivering member until 3 P.M. In any case

the Stock Clearing Corporation accepts no responsibility for the *form* of securities delivered through its Central Delivery Department. The third form of the credit list thus constitutes a receipt for the deliverer's messenger, for the delivery of the securities to the Central Delivery Department. Its first form is retained for the files of that Department, while the second form is sent to the Day Branch cage of the delivering member in order that the money value of the security deliveries upon it may be entered as a credit in his account there.<sup>5</sup>

**Central Delivery Department.**—The inside office of the Central Delivery Department is provided with tables for sorting securities, and racks of boxes for temporarily filing securities in process of being sent to Stock Exchange firms. When the security certificates come in at the receiving windows and have been counted and receipted for, they are sorted out on the tables according to the different firms to whom they are going. The security certificates composing a given delivery, together with the accompanying charge ticket, are placed in the box of the firm which is due to receive them.

After the delivering member's messenger has delivered the securities from his firm to the receiving windows of the Central Delivery Department as above described, he then goes to its delivering windows in order to obtain there the securities which all other Stock Exchange firms are delivering through the Department to his firm as a receiving member. These securities are already assembled in his firm's box in the inner office. At the delivering window allocated to his firm, the messenger's identity must first be established; this is done by means of the special card which he must carry. The messenger then receives the security certificates through the window, and after counting them signs the second form of the triplicate charge ticket attached to the security certificates composing each security delivery which he is receiving. The third forms of these charge tickets, attached to the security certificates themselves, the mes-

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<sup>5</sup> See Chapter XIV, p. 392.

senger takes away to the receiving firm's offices as memoranda for its files. The second forms of each charge ticket, signed by the receiving member's messenger, are retained by the Central Delivery Department as receipts for the deliveries it has made to the receiver's messenger. The first forms of each charge ticket, marked "Charge to the Account of the Delivering Member," are sent to the cage of the Day Branch where the account of the receiving member is kept, and the value of each security delivery made in this way is there entered as a debit item on the receiving member's account.<sup>6</sup> Thus, each trip of a messenger to the Central Delivery Department effects deliveries to many different firms, establishes credits therefor in his firm's account, receives securities from many different firms, and establishes debits therefor on his firm's account.

**Scope of Central Delivery Department Operations.**—The practice of centralized deliveries was inaugurated at first with only a few cleared stocks, with the aim of testing the system before extending it to other securities. At this writing, the system handles deliveries for all listed stocks and for cleared, but not for non-cleared, bonds. Security deliveries which are not handled through the Central Delivery Department are made as formerly direct to the receiving member's office, and the "deliver tickets" signed there will be sent to the Receiving Ticket Department of the Day Branch.

It will also be noted that the Central Delivery Department does not assume responsibility for the condition and deliverability of the securities delivered through it, by receiving them directly in the name of the Stock Clearing Corporation. It acts only as agent for its members, and while it counts the securities passing through it, if any question arises of improper deliverability (as for example, stock in a corporation name or married woman's name without adequate documents attached), it declares the delivery "ex-Clearing House" and leaves the

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<sup>6</sup> See Chapter XIV, p. 392.



question for the delivering and receiving members to settle between themselves.

**Deliveries From or To Banks.**—By special arrangements, the Stock Clearing Corporation also makes the services of its Central Delivery Department available to the New York banks, for deliveries of securities which the latter make to or receive from Stock Exchange firms. A given bank, for example, can deliver here during the day all securities going to all Stock Exchange houses, and receive here all securities coming from all Stock Exchange houses, and settle with one check at the end of the day. Similarly, a Stock Exchange firm can obtain the same advantages with all the securities which it has to deliver to all New York banks which employ the Central Delivery Department. Incorporated banks cannot be members of the Stock Exchange, and cannot be bound by Stock Clearing Corporation rules in the same way that Stock Exchange clearing members are. The relations of the incorporated banks and trust companies to the clearing system are fixed by special agreements. Therefore, somewhat different practices in respect to comparisons, delivery tickets, contingent lists, and methods of payment are employed with security deliveries to or from banks, than with those which occur between Stock Exchange members.<sup>7</sup>

A further extension of these non-member deliveries through the Central Delivery Department occurred in 1930, whereby the Stock Clearing Corporation made it possible for two non-member banking institutions in New York to receive and deliver securities with each other through the facilities of the Central Delivery Department.

**Future Development of Security Handling.**—The inauguration of the Central Delivery Department has already effected great economies to Stock Exchange firms and also to New York banks. Under the former system of delivering securities

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<sup>7</sup> See Appendix XIIIb.

direct from deliverer to receiver, a large Stock Exchange firm might have as many as 1,000 separate round lot deliveries to make to as many as 200 different firms. Such a house was in consequence compelled to maintain a large staff of messengers, since any delay in making deliveries each day before 2:15 P.M. would cause many "failures to deliver" with interest charges against the firm, or else clog the whole Stock Exchange settlement. But the delivery of stock securities at the Stock Clearing Corporation at 2:15 for the account of another member is the equivalent of direct delivery to the receiving member's office. The present centralization of deliveries, therefore, which permits a messenger by a single trip to the Central Delivery Department, to make all his firm's available deliveries of securities handled there to all receiving firms, and obtain for his firm all the similar security deliveries which have come to it from all other deliverers, has thus produced large economies of time and messenger hire, and led to sounder and better methods in many ways.

But an examination of certain European security settlement systems, particularly those centering in the Bank des Berliner Kassen-Vereins, should speedily persuade anyone familiar with security markets, that the New York Stock Exchange can still do much to improve its methods of security handling. To this task a special committee on Centralization has for several years addressed itself, and it is only fair to state that the centralization of security deliveries may prove only an initial step in the establishment of several very economic and superior yet quite far-reaching and radically new methods of handling securities.

Even at the risk of suffering the fate of most prophets, the writer wishes to express an entirely personal opinion as to the direction which these changes may take. Once centralization of security deliveries is completely established, it may then be possible to place the Stock Clearing Corporation directly vis-à-vis to its members on all security deliveries. Thus, instead of delivering or receiving securities *through* it, the members

would make all deliveries *to* it and receive all deliveries *from* it. This would make the Stock Clearing Corporation responsible for accepting delivery on all security certificates, in respect to their technical deliverability, and would in proportion lift this responsibility from its members.

It might then be possible to establish a central depository, and allow Stock Exchange members to keep securities on deposit therein subject to check, just as is done by everyone every day with their money funds in bank deposits. Such a practice would enable Stock Exchange members to withdraw securities by "cashing" a security check, and would also permit the delivery of a security from one member to another by the delivery of a security check to the receiver, who could then "cash" it and draw out the security, or "deposit" it to its security account. In this way, as in the Giro-Effekten-Depot of the Bank des Berliner Kassen-Vereins, securities could be kept securely guarded in vaults, instead of circulating round and round the financial district each day, even while the ownership of the securities was being constantly changed from one member's account to another. A final step would be the inclusion in the system of the securities which serve as loan collateral.

Radically novel as these ideas may perhaps sound to the veteran of Wall Street brokerage or banking, they have been actually practised to enormous advantage on the Berliner Borse and in the Bank des Berliner Kassen-Vereins for many years. There seems no inherent reason why some day listed securities in New York cannot be handled by these time-tested German methods with the enhanced convenience, safety, and economy which is already familiar to us all from the ever-present example of check and deposit banking.

**Clearance of Loans.**—The Stock Clearing Corporation provides facilities for the clearance and settlement of security collateral loans as well as of Stock Exchange purchase and

sale contracts. A description has already been given<sup>8</sup> of the methods whereby commission houses finance their transactions in securities requiring credit accommodations, by means of these collateral time and call loans. The latter type, since they are payable on demand, are constantly being shifted. Formerly this process of shifting a demand loan from one lender to another, created a fairly steady need of temporary banking accommodation on the part of Stock Exchange houses.

In case Jenkins & Co. had its loan for \$100,000 called by the lending bank A, the firm would make an agreement with bank B to obtain from it a similar sum on the collateral then reposing in A's vaults. But Jenkins & Co. might not find it convenient to obtain this security collateral from A until it had B's check for \$100,000 with which to retire A's loan; on the other hand, Jenkins & Co. could not obtain the funds from B until it had delivered the same security collateral to B's loan window. Thus Jenkins & Co. might find itself in the temporary dilemma of not being able to get the money loan until it got its securities, and not being able to get its securities until it got the money loan.

This situation was somewhat similar to that previously described<sup>9</sup> in connection with the receipt and delivery of securities which the firm had purchased and sold, and it was solved in much the same way. Just as the banks make "day loans" to brokers which enable the latter to pay for securities which they have purchased and are due to receive in the settlement, so too "day loans" are furnished the brokers as temporary accommodation for a few hours wherewith to shift collateral loans. Thus, Jenkins & Co. would obtain such a "day loan" at Bank C, draw upon it and have certified a check for \$100,000, deliver the check to A, get the security collateral, turn it over to B, get B's check for \$100,000 and turn it over to C, thus retiring the firm's "day loan" at the latter institution.

In order to effect an economy in the amount of such "day

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<sup>8</sup> See Chapter XI, p. 287.

<sup>9</sup> *Ibid.*, p. 295.

loans" contracted by Stock Exchange members, the Stock Clearing Corporation in 1921 undertook to clear call and time loans, and by intervening as an intermediary when loans have to be shifted, to render unnecessary the use of certified checks from "certifying banks."

**The "Lending Members."**—The Stock Clearing Corporation undertakes to clear loans only for its regular clearing members. But in addition to these, who in the main appear in loan clearances as borrowers, the representatives of financial institutions that lend money on call constitute a class of "lending members." These lending institutions have signed an agreement with the Stock Clearing Corporation which permits the routine of loan clearance to be carried on smoothly and efficiently. For the use of these "lending members," booths are provided in the Day Branch of the Stock Clearing Corporation, wherein the lenders' representatives can receive or deliver security collateral and checks for their money amounts. This loan clearance is not compulsory but optional with all parties concerned.

**The Return Loan Agreement.**—In explaining the clearance of loans, the simplest method is to start with the operations by which an existing loan is paid off; next, to consider how the Stock Clearing Corporation holds the collateral and enables it to be shifted and withdrawn in whole or in part; and finally, to describe the methods employed in making a new loan.

The repayment of loans starts at 10 A.M. each full business day. Of course, a loan may have to be paid off because either the lender has called it, or because the borrower desires to pay it off. Notice to this effect is given direct between borrower and lender, usually over the telephone. When a loan is paid off by a non-member of the Stock Clearing Corporation, the borrower must obtain his security collateral from the lender by delivering at the latter's office a certified check for the prin-



FIRST ORIGINAL

(Day Branch)

Called  
Returned

New York July 2nd, 1929

*Fiftieth National Bank* to pay off this day a Loan  
dated *July 1<sup>st</sup> 1945* \$*100,000* and interest \$*16.67*

Total Charges \$100.016 <sup>67</sup>/<sub>8</sub> — in accordance with and subject to the By-Laws and Rules of the Stock Clearing Corporation.

1,400

The securities held by the lender as collateral for the above loan are to be delivered to the Stock Clearing Corporation. The borrower directs the Stock Clearing Corporation to pay the amount of said loan with accrued interest and to hold said securities for his account subject to the By-Laws and Rules of the Stock Clearing Corporation.

*Fiftieth National Bank*      *Jenkins & Co.*  
Lender Signs      Borrower Signs

The delivery to the Stock Clearing Corporation of the securities named above is hereby acknowledged.

*Fiftieth National Bank*      *Jenkins & Co.*  
Lender Signs      Borrower Signs

Figure 37. Return Loan Agreement

principal and interest of the loan in the manner described in the present and an earlier chapter.<sup>10</sup>

When a clearing member pays off a loan through the Stock Clearing Corporation, the borrower first fills out a quadruplicate return loan agreement in his office. This brown form (Figure 37) contains the borrower's clearing number, the names of the borrower and lender, the amount of the principal and interest of the loan, as well as an itemized list of the securities pledged as collateral for the loan and held in the envelope by the lender, together with the number of shares, the price,

|                                                                       |                                                                                          |                                                                   |
|-----------------------------------------------------------------------|------------------------------------------------------------------------------------------|-------------------------------------------------------------------|
| For Account of<br>J. C. B. & Co.<br>WITH SIGNATURE OF CLEARING MEMBER | <b>Stock Clearing Corporation</b><br>8 Broad Street                                      | S.C.C. No. <u>400</u><br>\$100,016 <sup>67</sup> / <sub>100</sub> |
|                                                                       | New York July 2 <sup>nd</sup> , 1929                                                     |                                                                   |
|                                                                       | Pay to the order of <u>The Sixtieth National Bank</u>                                    |                                                                   |
|                                                                       | <u>One hundred thousand sixteen and <sup>67</sup>/<sub>100</sub></u> Dollars             |                                                                   |
|                                                                       | To <u>Sixtieth National Bank</u> <u>John Smith, Seller</u><br>Stock Clearing Corporation |                                                                   |

Figure 38. Stock Clearing Corporation Check for Pay-Off Loan

and the value of each. The borrower signs the three forms of this agreement with a signature recognized by the Stock Clearing Corporation, for although the form is in quadruplicate, only three forms are used in paying off loans. At the same time the borrower fills out a credit memorandum (Figure 38) form which he signs on the left edge, making payable to the lender the amount of the principal and interest of the loan in question. The form, of course, possesses no value as a check until it is signed by an official of the Stock Clearing Corporation, and until the latter designates one of its depository banks to which the lender should present it for payment. At first, therefore, the borrower fills out all but the bottom line of the form, where space is left for these two important items to be filled in later.

<sup>10</sup> See Chapter XI, p. 295.

**Notification of the Lender and the Clearing Corporation.**

—The borrower's representative then takes the return loan agreement to the lender's office. The receipt of the return loan agreement by the lender constitutes a notification to him from the borrower that the loan will be paid off. The lender detaches one of the three forms of the return loan agreement, signs the other two forms, and returns them to the borrower's representative. The latter then takes these two forms, together with the credit memorandum above described, to the Day Branch of the Stock Clearing Corporation, and delivers both agreements and memorandum to the particular cage in which the account of his firm is kept. Thus the Stock Clearing Corporation is notified concerning the clearance to be made, and has on the face of the agreement the list of securities which it must receive from the lender in behalf of the borrower. The Corporation reserves the right to refuse to act, in which case the loan must be paid off "ex," in the manner described in Chapter XI.

**Making Payment to the Lender.**—The next step is taken by the lender's representative, who comes to his booth in the Stock Clearing Corporation with his copy of the return loan agreement and the envelope of security collateral itemized on its face. He goes to the cage where the borrower's account is kept and delivers the loan envelope and its contents. The clerk in the cage compares the securities in the envelope with the itemized list on the face of the return loan agreements previously received from the borrower. If the securities in the envelope agree with this list in all respects, the clerk retains the security collateral for the account of the borrower. The first teller of the cage, as an authorized representative of the Stock Clearing Corporation, then signs the credit memorandum (Figure 38) previously left there by the borrower, and under the word "To" fills in the name of a bank where part of the clearing fund is deposited. Thus the credit memorandum becomes the check of the Stock Clearing Corporation, drawn on

the depository bank in favor of the lender. This check is then handed to the lender. So financially sound is the Corporation, with its large clearing fund always on deposit as a liquid and revolving fund, that its checks are not certified. The lender collects the proceeds of the check he receives, through the Bank Clearing House.

If the lender desires a receipt for the securities he has delivered to the Stock Clearing Corporation, the latter will sign to that effect on the return loan agreement form brought to the Stock Clearing Corporation by the lender.

**"Secured" and "Unsecured" Accommodation.**—Meanwhile, in the borrower's cage at the Stock Clearing Corporation, the securities constituting the collateral to the loan paid off are held for the borrower's account, and he is debited with the amount of the principal and interest of the loan which the Stock Clearing Corporation has just paid to the lender on the borrower's behalf. But it must be noticed that this debit item is not "unsecured accommodation," as is the case with debits incurred by clearing members through receiving stock balances. For, to balance the debit of the borrower on the Stock Clearing Corporation's books which was created when the latter paid off the loan to the lender, the Corporation holds the security collateral. Consequently, this debit item is "secured accommodation" and is dealt with as such on the books of the Corporation. A separate sheet<sup>11</sup> in each cage contains the summarized account of both the secured and unsecured accommodation employed by each member, as well as their offsetting credit items. Thus the Stock Clearing Corporation at all times can tell to a penny the exact financial position with it of the clearing member in question. The collateral received by the Stock Clearing Corporation is almost automatically acceptable to it, since the lender was willing to hold it overnight.

The above operations take place during the morning in two shifts. If the borrower takes the return loan agreement to the

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<sup>11</sup> See Chapter XIV, p. 401.

lender's office by 10:15 A.M., the lender delivers the security collateral to the Stock Clearing Corporation by 10:30 A.M. But if the agreement does not reach the lender until after 10:15 A.M. the matter goes over until 12:30 P.M., by which time all agreements for the paying of loans to be effected through the Stock Clearing Corporation that day must reach the lender. The lender then leaves his office immediately after the last loan agreement has been received, and comes to the Stock Clearing Corporation, bringing with him the collateral to the loans which are to be paid off to him; as between Stock Exchange members by rule in the Stock Exchange Constitution (Rules, Chapter III, Sec. 3), and with lenders in Wall Street without law but by long established custom, no loans are called after 12:15.

Against such checks as the Stock Clearing Corporation pays to lenders in behalf of borrowers who are paying off loans, it deposits in the banks upon which these checks are drawn funds arising from certified checks, or bank checks received by it during the day representing payments to it by its clearing members either for security balances received, or for new loans made, or for the final daily settlement of its account by the clearing member with the Stock Clearing Corporation.

**Withdrawal of Collateral Securities "Free."**—We must now consider some of the problems which arise after the Stock Clearing Corporation has paid off a loan for a borrower and while it holds the borrower's collateral securities. Usually the borrower will need some or all of the securities held in this way by the Stock Clearing Corporation for the routine business of the day. Perhaps the envelope at the Corporation contains a certificate for 100 shares of U. S. Steel which he must deliver on balance to another clearing member whose name the Night Branch has given him; or perhaps the borrower may wish to get this 100 shares of Steel in order to substitute it for 100 shares of Reading which he has to deliver but which is at present in another loan envelope at a bank as collateral for another loan. The Stock Clearing Corporation will permit the



clearing member to withdraw such certificates from his collateral "free"—that is, without at the same time having to give in return to the Corporation his certified check or equivalent securities for the value of the securities withdrawn—up to the limit of the credit accommodation to which the given member is entitled at the Stock Clearing Corporation on the basis of his contribution to its clearing fund. But in addition to this ordinary credit accommodation, the member can obtain additional accommodation at the Stock Clearing Corporation by making an additional temporary contribution to its clearing fund, or by reducing his existing accommodation by establishing actual credits at the Corporation through delivering securities to other members, by contracting new collateral loans from the banks through the Corporation, or by delivering securities or sending funds direct to his account at the Corporation. The form used in withdrawing securities is shown in Figure 39.

Thus, the value of securities delivered "free" in this way is treated as unsecured accommodation extended temporarily to the member by the Stock Clearing Corporation, and hence it is debited to his account there along with other unsecured debits which he incurs by receiving securities, etc. The member's "record sheet" upon which such debits are entered will be described in the next chapter.<sup>12</sup> Of course, the clearing member, whether for security balances received or for securities withdrawn free, is not permitted to obtain a greater total of unsecured accommodation from the Corporation than the amount which it allows him. The member can, however, obtain special accommodation in giving his certified check or securities to the Stock Clearing Corporation. Consequently, if the member were to withdraw securities from his collateral unnecessarily, he would to the extent of their value needlessly increase the amount of his debit for unsecured accommodation extended to him by the Corporation. In an active day particularly, it is necessary for the clearing member to keep this

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<sup>12</sup> See Chapter XIV, p. 401.

accommodation as liquid as possible. If he withdrew too many securities he might overextend his position on the Corporation's books and be forced to send it a check or securities. Thus the privilege of withdrawing securities free from his collateral with the Corporation is not abused.

**Procedure with Withdrawal of Securities.**—The routine for withdrawing securities free from collateral at the Stock Clearing Corporation is very simple. The clearing member fills out a form (Figure 39) which constitutes a receipt by the clearing member for the securities to be withdrawn and which states the number of shares, name, price, and value of these securities. This form, when properly filled out, is presented by the clearing member's representative at the cage in the Stock Clearing Corporation in which his account is kept. If the operation does not involve an employment of more accommodation than the member is entitled to, the clerk in the cage retains the receipt form, delivers to the clearing member's representative free the securities he desires to withdraw, and debits the firm's unsecured accommodation account with their value.

**Subsequent Employment of Remaining Securities.**—The securities left with the Stock Clearing Corporation as collateral for a paid-off loan, subject of course to this process of withdrawals, may remain with the Corporation until the end of the day, when, if the clearing member's account is in debit, he may settle with the Corporation for their value with his final check, and take them away. Often, however, they are employed as collateral for a new loan to be made, the proceeds of which the clearing member will usually need either for settling his indebtedness with the Corporation at the close of the day's business, or in connection with his ex-Stock Clearing Corporation operations. We must, therefore, next consider exactly how new loans are made through the agency of the Stock Clearing Corporation.



**The New Loan Agreement.**—The borrower first makes out in his office a new loan agreement, which in several respects resembles the return loan agreement already described. The new loan agreement form (Figure 40) is in quadruplicate and contains the borrower's clearing number at its head, as well as a formal agreement stating that the lender has agreed to loan to the borrower in accordance with and subject to the By-laws and Rules of the Stock Clearing Corporation a stated sum of money at a stated interest rate, upon the collateral of an appended itemized list of securities. This itemized list states the name, number, price, and value of the securities to be pledged for the loan. After filling out the four forms of this new loan agreement, the borrower signs them at the bottom, and his representative takes the agreement to the office of the lender.

Here, the lender passes on the desirability of the security collateral itemized on the face of the agreement. If the collateral is acceptable to him, he detaches two of the four forms of the agreement for his own use, and, after signing the other two forms in the space provided for that purpose at the bottom, returns these to the borrower's representative. But in case the collateral for the proposed loan is not acceptable to the lender, the latter rejects the agreement and requests the borrower to pledge other securities than those on the list as collateral. In such cases the borrower proceeds to make up a new list of securities and a new agreement which will be acceptable to the lender, and sends it back to the latter for his approval and signature in the manner above described. These new loan agreements for new loans to be "put through" the Stock Clearing Corporation are accepted by lenders up to 2:45 P.M. In case a borrower sends his agreement to the lender after that time, the lender can insist that the loan be made "ex," in which case, of course, the Stock Clearing Corporation does not figure further in the matter.





**Notifying the Stock Clearing Corporation.**—The borrower's representative next takes the two forms of the new loan agreement, which have by this time been signed by both borrower and lender, to the Stock Clearing Corporation. He delivers them at the particular cage there where the account of the borrower as a clearing member is kept, and the clerk in the cage files them for future reference. Thus, the Stock Clearing Corporation is officially notified that it must be prepared to act as agent for borrower and lender in handling the loan about to be made. Under certain circumstances, however, the Stock Clearing Corporation reserves the right to refuse to act, in which case the loan must be made "ex."

Representatives of lending institutions usually pay three calls a day at the Stock Clearing Corporation; at 10:00 A.M. and 12:30 P.M. for paid-off loans and at 2:30 for new loans. With new loans, they bring forms of the new loan agreement previously detached and retained at the lender's office, as well as the check of the lending institution made out payable to the Stock Clearing Corporation for the account of the borrower, for the principal of the new loan to be made. It may be that all the securities to be used as collateral for the new loan have already been deposited with the Stock Clearing Corporation as the result of a previous loan which the Corporation already has paid off in behalf of the borrower.

**Making the New Loan.**—In consequence of the lender having shown that he has approved the collateral pledged for the loan by signing the new loan agreement, the lender's representative has only to see that the securities he obtains are identical with those stated upon the new loan agreement form which he has, and that the certificates are in such negotiable shape as to conform with his requirements. About 2:30 P.M., therefore, the lender's representative obtains the security collateral for the new loan from the cage where the borrowing clearing member's account is kept, and at the same time delivers to the clerk in that cage the check of the lending insti-

tution for the amount of the loan, made payable to the Stock Clearing Corporation for the borrower's account. Thus the lender has his collateral, has paid over the principal of the loan, and is now finished with his part in making the particular loan.

Further details of the operation, however, remain to be concluded between the borrower and the Stock Clearing Corporation. The latter, on receipt of the lender's check, credits it to the account of the borrower. If this leaves the borrower with a large credit balance at the Corporation, he can under certain restrictions draw this down, as we will see in the next chapter.<sup>13</sup> On the other hand, if before the receipt of the lender's check by the Stock Clearing Corporation the borrower's account with the Corporation contained a heavy debit balance, the deduction from this debit balance of the check for the new loan turned over to the Corporation will materially assist in restoring the borrower's credit or debit balances with the Stock Clearing Corporation nearer to a proper proportion.

**Future Simplification of Loan Clearance.**—The clearance of loans as above described was inaugurated by the Stock Clearing Corporation in 1921. But when the Central Delivery Department was established in 1929, a means was created whereby Stock Exchange members and New York banking institutions (not members of the Exchange) could deliver and pay for securities between each other. These new facilities have so far been employed for purchases and sales of securities only, yet they might be readily utilized to handle the payment of new loan-funds and the delivery of collateral to the lender, or conversely the repayment of old loans and the return of collateral to the borrower. If handled as simply an affair of debits and credits between New York banking institutions and Stock Exchange firms, as is already done with sold or purchased securities, it would greatly reduce the clerical work now

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<sup>13</sup> See Chapter XIV, p. 397.

imposed by the special loan agreement forms described on the preceding pages.

At this writing, the Stock Clearing Corporation has under consideration plans for effecting this further step in simplifying its procedure.

**The Case of Lending Clearing Members.**—In the routine for the paying of old loans and the making of new ones above described, one important variation should be noticed. In case the lender is also a clearing member his account is, of course, kept at the Stock Clearing Corporation along with that of the borrower. This fact enables a still more economical method to be employed in clearing loans made between the two, which is in several ways analogous to the method employed by the Stock Clearing Corporation in crediting or debiting its members' accounts for stock balances which have been delivered or received.<sup>14</sup>

The same forms are employed in a clearance of loans between two clearing members as in the clearance of loans between a clearing and a lending member already described, with the exception of the payment of the principal of a new loan, or the repayment of the principal and interest on an old loan. The clearing member who acts as a lender is assigned a booth in the Stock Clearing Corporation where he must have his representatives to handle the security collateral and other matters involved in the same way as other lenders of money. But instead of a credit memorandum which becomes a check of the Corporation, or of a bank check, credit and charge tickets are employed in the manner about to be described in the following paragraphs.

**Paying Off Loans to Lending Clearing Members.**—When a loan is to be paid off, the lending clearing member delivers its collateral securities to the Stock Clearing Corporation at the borrower's cage. The borrower, in the meantime, has

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<sup>14</sup> See Chapter XIV, p. 399.

brought in a special gray form, which is in duplicate, consisting of a credit ticket, printed in red (Figure 41a), and a charge ticket, printed in black (Figure 41b). Attached to each is a stub which serves as a receipt for the lender and the borrower respectively. The credit ticket consists of an order signed by the borrower upon the Stock Clearing Corporation to credit the lender's account for the principal and interest of the loan to be paid. This ticket must also be approved by the Corporation, and signed by one of its tellers. The charge ticket, on the other hand, which is the other half of the form, is a signed order by the borrower upon the Stock Clearing Corporation to charge his account with the amount of the principal and interest of the loan.

The clerk of the borrower's cage then detaches the charge ticket, in order to debit the account of the borrower for the principal and interest of the loan paid off, and gives the credit ticket to the lender. The latter then files this ticket at the cage where his own account is kept, and thereby receives credit on the books of the Stock Clearing Corporation for the principal and interest of the loan paid off. The clerk at his own cage detaches the stub to the credit ticket and returns it to the lender as a receipt for the credit he has obtained on the books of the Stock Clearing Corporation for the principal and interest of the loan paid off. Thus it is not necessary for the Stock Clearing Corporation to pay the lender with one of its own checks; the whole transaction is finally settled when the lending and borrowing clearing members make their final settlement with the Stock Clearing Corporation for the day.<sup>15</sup>

**New Loans Made by Lending Clearing Members.**—An analogous procedure is followed in the making of new loans where the lender is a clearing member. The lender first makes out a duplicate white form consisting of a credit ticket, printed in red (Figure 42a), and a charge ticket, printed in black (Figure 42b). Attached to each is a stub later used as a

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<sup>15</sup> See Chapter XIV, p. 400.

## STOCK CLEARING CORPORATION

8 BROAD STREET

Date July 2nd 1929Clearing No. 470

Lender

Clearing No. 400

Borrower

Principal & Int. of loan \$ 100,016<sup>67</sup>/<sub>X</sub>

Entered:

S. C. C. No. 470

Lender

New York, July 2nd, 1929\$ 100,016<sup>67</sup>/<sub>X</sub>Credit the account of Harrison & Co.  
One hundred thousand and sixteen and <sup>67</sup>/<sub>X</sub> Dollars

PRINCIPAL AND INTEREST OF A LOAN TO BE PAID TO-DAY as advised on quadruplicate agreement previously filed with Stock Clearing Corporation against which we have received as stated the securities held by them as collateral.

Approved:

STOCK CLEARING CORPORATION,

John Smith  
TellerJenkins & Co.  
Borrower

Figure 41a. Pay-Off Loan Credit Ticket

Used when one clearing member pays off principal and interest of a loan made to him by another clearing member. This ticket is used to credit the proceeds to the account of the lender.

## STOCK CLEARING CORPORATION

8 BROAD STREET

Date July 2nd 1929Clearing No. 470

Lender

Clearing No. 400

Borrower

Principal & Int. of loan \$ 100,016<sup>67</sup>/<sub>X</sub>

Entered:

S. C. C. No. 400

Borrower

New York, July 2nd, 1929\$ 100,016<sup>67</sup>/<sub>X</sub>Credit the account of Harrison & Co.  
One hundred thousand and sixteen and <sup>67</sup>/<sub>X</sub> Dollars**Charge** our account for the payment as advised on quadruplicate agreement previously filed with Stock Clearing Corporation of principal and interest of a loan against which we have received the securities held by them as collateral.

Approved:

STOCK CLEARING CORPORATION,

John Smith  
TellerJenkins & Co.  
Borrower

Figure 41b. Pay-Off Loan Charge Ticket

This ticket is used to charge to the account of the borrower the principal and interest of the loan paid off.



## STOCK CLEARING CORPORATION

8 BROAD STREET

Date July 2nd 1929.Clearing No. 480  
LenderClearing No. 400  
BorrowerPrincipal  
of loan \$ 100,000

Entered:

S. C. C. No. 480  
Lender

New York,

\$ 100,000  
July 2nd 1929.CREDIT the account of Jenkins & Co.One hundred thousand

Dollars

PRINCIPAL OF A LOAN MADE TO THEM as advised on quadruplicate agreement previously filed with Stock Clearing Corporation and from whom we have received as collateral the securities mentioned thereon.

Approved:

STOCK CLEARING CORPORATION,

John Smith  
TellerThompson & Co.  
LENDER

Figure 42a. New Loan Credit Ticket

Used when one clearing member makes a loan to another. This credits the borrower's account with principal of the loan.

## STOCK CLEARING CORPORATION

8 BROAD STREET

Date July 2nd 1929.Clearing No. 480  
LenderClearing No. 400  
BorrowerPrincipal  
of loan \$ 100,000

Entered:

S. C. C. No. 400  
Borrower

New York,

\$ 100,000  
July 2nd 1929.On account of loan to Jenkins & Co.One hundred thousand

for

Dollars

CHARGE <sup>my</sup> account with the above stated amount as advised on quadruplicate agreement previously filed with Stock Clearing Corporation representing the principal of a loan against which we have received as collateral the securities mentioned thereon.

Approved

STOCK CLEARING CORPORATION,

John Smith  
TellerThompson & Co.  
LENDER

Figure 42b. New Loan Charge Ticket

This charges the account of the lending clearing member with principal of loan made to the borrowing clearing member.

receipt. The credit ticket is a signed order by the lender upon the Stock Clearing Corporation to credit the account of the borrower with the principal of the new loan. The charge ticket, on the other hand, is an order signed by the lender upon the Stock Clearing Corporation to charge the lender's account with the principal of the loan, and states that the lender has received as collateral the securities pledged to obtain it. Both credit and charge tickets must be approved by the Stock Clearing Corporation and to that effect bear the signature of one of its tellers.

The lender delivers this form to the cage in the Stock Clearing Corporation where his own account is kept. The form is then torn apart along the perforated line, and the charge ticket is retained in the cage to debit the lender's account for the amount of the loan. The lender is given its stub as evidence of this charge. The credit ticket is then given to the borrower, after he has delivered the collateral either to the lender or at the lender's cage, and the borrower's account is credited with the proceeds of the new loan.

**Final Settlement with the Stock Clearing Corporation.**—Clearing members settle all their day's business with the Stock Clearing Corporation with one check or one draft. For this reason, the settlement of loan transactions with it is made together with the settlement for delivery and receipt of cleared and non-cleared securities and other matters. The detailed description of this final money settlement will accordingly be left to the next chapter.<sup>16</sup>

As for security collateral, there often remains a residue of it at the Stock Clearing Corporation in the account of a clearing member. This residue results from the fact that not all the securities placed with the Corporation are withdrawn "free" during the remainder of the day, for reasons already given. At the end of the day, therefore, the clearing member

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<sup>16</sup> See Chapter XIV.

takes up such securities remaining in his account at the Corporation, after his final money settlement with it has been made.

**The Transfer Department.**—Another service rendered by the Stock Clearing Corporation consists in rendering liquid registered securities whose certificates are for the time being tied up in transfer.

In Wall Street it has long been the custom of Stock Exchange firms to put in for transfer into their names, registered shares in the names of other firms, just before the transfer books close for dividends. In this way, sometimes very considerable amounts of securities belonging to stockbrokers or to their customers used to be tied up in the offices of company transfer offices or agents, and thus not be available for use as security collateral. In consequence, a heavy though temporary burden was formerly thrown on the capital of Stock Exchange houses.

To overcome this recurrent annoyance, in 1923 the Stock Clearing Corporation organized its Transfer Department, and housed it in the Day Branch; subsequently, as the volume of business grew, it was provided with a larger basement office. When a Stock Exchange firm now has securities which it wishes to put into transfer and at the same time borrow upon, it takes them to this Transfer Department and delivers them into its windows. In exchange the firm obtains an engraved certificate known as an "assignable transfer receipt," which states on its face that the Stock Clearing Corporation has received certificates for a specified number of shares of a specified stock issue, that these certificates are to be put into transfer, and that upon surrender of the transfer receipt, the Stock Clearing Corporation will deliver the new certificates to the transferee or to the persons to whom he may endorse the receipt, or if the certificate is endorsed in blank to the bearer.<sup>17</sup> Assignable transfer receipts are not supposed to be outstanding longer

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<sup>17</sup> See Appendix XIIIc.

than five days; if so, the old receipt is called in, and a new one is issued.

Lenders on security collateral have agreed to accept these receipts in lieu of the actual security certificates which they represent. In this way a Stock Exchange firm may deliver stock certificates to the Transfer Department to be put by it into transfer, obtain from it a transfer receipt, and employ this receipt as collateral for loans until the newly transferred security certificates have been prepared and can be obtained at the Transfer Department. Thus, during periods when large amounts of stock are in transfer, illiquidity is obviated, and no especial strain thereby is thrown upon the capital of Stock Exchange firms. Since a regular stock assignment form is printed on the back of the receipt, the borrower on security collateral by assigning the receipt to the lender or in blank can enable the lender to sell it in case he wishes to exercise this privilege under a loan agreement; thus the transfer receipt is "assignable."

**Exchange Receipts.**—Sometimes, when an old issue of securities is rendered exchangeable for a new issue, a tie-up of the old securities submitted for such exchange may occur. To protect Stock Exchange members against this contingency, the Stock Clearing Corporation provides another kind of receipt, known as an "exchange receipt."<sup>18</sup> Thus (as previously with a transfer receipt) a member can turn his old securities to the Transfer Department, obtain "exchange receipts" for them, and employ these as loan collateral by making assignment on their backs, until the new securities obtained in exchange for the old securities are ready at the Transfer Department; he then obtains the new securities by presenting and surrendering the "exchange receipt."

**Temporary Exchange Receipt.**—When the Stock Exchange member wishes (as for example in the case of rights to subscribe) to exchange old securities and money for new

<sup>18</sup> See Appendix XIIIId.

securities through the Transfer Department, this can be done by a third form of receipt—the “temporary exchange receipt,” whose text provides for the receipt of money by the Stock Clearing Corporation as well as for the receipt by it of securities.<sup>19</sup> With this exception, “temporary exchange receipts” are like “exchange receipts” and are issued, employed, and withdrawn in the same way. •

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<sup>19</sup> See Appendix XIIIc.



## CHAPTER XIV

### MONEY CLEARANCE AND SETTLEMENT

**The Concluding Phases of the Settlement Process.**—Of the five basic steps which compose the settlement process, comparison and security clearance were described in Chapter XII, and security delivery in Chapter XIII. In the latter, loan clearance and the issuance of transfer receipts were also explained. In the present chapter it remains to describe the last two stages of the settlement process—money clearance and money settlement, which are carried on in the Day Branch of the Stock Clearing Corporation.

**Quarters of the Stock Clearing Corporation.**—It has been pointed out that the Night Branch of the Stock Clearing Corporation (including its Distributing Department and its Clearance Department) is located at 55 New Street. All the rest of the Stock Clearing Corporation offices are housed in the basement of the Stock Exchange building itself, immediately beneath the Exchange floor. Under the Wall Street extension of the floor is the Central Delivery Department, whose operations have already been described. Beneath the old Board Room of the Exchange are the Day Branch headquarters; its outer walls are lined with the booths or cages for the large New York banking institutions whose operations in connection with loan clearance and non-member deliveries have been outlined. The center of the room is occupied by a hollow square of banking cages in which the accounts of the clearing members are kept. Inside this square space is provided for sorting and checking the “three-way exchange tickets” on non-cleared securities, and also the charge and credit tickets, before these are sent to their appropriate cages and entered in the clearing

members' records in the manner presently to be described. Along the outer walls of the floor are cages for the banks, and also the managerial offices of the Day Branch. Adjoining the Day Branch offices are the offices of the President and Board of Directors of the Stock Clearing Corporation. On a lower floor the Transfer Department is located.

Since a considerable amount of securities flows through the Day Branch offices, and since any sudden interruption of its daily activities would seriously interfere with the smooth accomplishment of the whole settlement, the Stock Clearing Corporation headquarters are closely guarded, and are equipped with the most modern and complete lighting, ventilating, and protective devices.

**Keeping of Member Accounts.**—The primary function of the Day Branch is to facilitate the clearance and settlement of money accounts between the clearing members. Each clearing member is, as we have seen,<sup>1</sup> assigned a "clearing number," and his account is known by this number rather than by name throughout the whole process of settlement. Each of the eleven Day Branch cages has a theoretical capacity of 60 different accounts, and thus they are numbered 1–60, 61–120, etc. Thus any given clearing member's account is kept in the cage whose numbers include his clearing number.

For each member account a "record sheet" is kept, upon which are entered all the credit or debit items incurred by him during the day, either from delivery or receipt of security deliveries, or from loans shifted, or from other causes. Thus all these transactions, which would otherwise cause the issuance and delivery of money checks between Stock Exchange firms, are handled by book entries on the record sheets of their accounts at the Stock Clearing Corporation. At the end of the day, each member's account is balanced; if he has a debit balance he sends a single check to the Stock Clearing Corporation to settle his whole account with it, while if he has a credit

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<sup>1</sup> See Chapter XII, p. 329.

balance he draws a single draft against the Stock Clearing Corporation. The savings which this method make possible are, as we shall see, enormous.

**Cleared Security Debit Contingent Lists.**—Naturally it is highly important that the Day Branch get an accurate idea of the magnitude of each clearing member's prospective money transactions in the money settlement each day, before this settlement actually begins. This is the reason for its use of the "contingent lists."

We have seen<sup>2</sup> that in cleared securities the Night Branch in the course of its security clearance reduces all contracts between Stock Exchange members to balances which issue by issue are priced at "delivery" or "settlement" prices. Thus, the first thing each morning, each clearing member knows just what security balances he must deliver and receive that day, and consequently how much money he will take in and pay out in the settlement. Accordingly, he makes out a "debit contingent list" itemizing all the security balances which he must receive and pay for. These "debit contingent lists" for cleared securities are printed in black on white paper (Figure 43), and for cleared bonds in black on pink paper. Attached to this form is a perforated slip for "failures to receive." On the back of the debit list is an assignment form whereby the firm making out the list pledges the securities mentioned on the list to the Stock Clearing Corporation, to secure the latter for sums due to it from the firm.<sup>3</sup>

These contingent debit lists for securities cleared at the Night Branch are made out early in the day and sent to the Day Branch. The total money amounts of contingent debits are then entered on each member's Day Branch "record sheet" in the columns provided for such entries. Thus, as far as the money value of deliverable balances in cleared securities is concerned, each member's "record sheet" at the beginning of

<sup>2</sup> See Chapter XII, p. 329.

<sup>3</sup> See Appendix XIVa.

| STOCK CLEARING CORPORATION (DAY BRANCH)                                            |                          |                  |                |       | Stock Clearing Corporation<br>DAY BRANCH                                                                         |                        |
|------------------------------------------------------------------------------------|--------------------------|------------------|----------------|-------|------------------------------------------------------------------------------------------------------------------|------------------------|
| Contingent Debit List for value of Security Balance orders to                      |                          |                  |                |       | STOCKS                                                                                                           |                        |
| Receive as per Night Clearing Sheets dated <u>July 2nd 1929</u>                    |                          |                  |                |       | Failed to Receive                                                                                                |                        |
| Stamp Name of Member <u>Jenkins &amp; Co.</u>                                      |                          |                  |                |       | Total value of which credit to our account                                                                       |                        |
| Blotter Line No.<br>or<br>M. M. Entry                                              | Receive from             | No. of<br>Shares | Stocks         | Price | Value<br>Stocks                                                                                                  | Value<br>Failed Stocks |
| 1                                                                                  | <u>J. Long &amp; Co.</u> | 200              | <u>Reading</u> | 105   | 21 000                                                                                                           |                        |
| 2                                                                                  |                          |                  |                |       |                                                                                                                  |                        |
| 3                                                                                  |                          |                  |                |       |                                                                                                                  |                        |
| 4                                                                                  |                          |                  |                |       |                                                                                                                  |                        |
| 18                                                                                 |                          |                  |                |       |                                                                                                                  |                        |
| 19                                                                                 |                          |                  |                |       |                                                                                                                  |                        |
| 7                                                                                  |                          |                  |                |       |                                                                                                                  |                        |
|                                                                                    |                          |                  |                |       | 21 000                                                                                                           |                        |
| Drafts on Acct.<br>Actual Balances<br>Actual Non-Cd.<br>Loans<br>" Between Members |                          |                  |                |       | Member enters total only. <input checked="" type="checkbox"/><br>Make no other entries<br>below last heavy line. |                        |
| Drafts Paid<br>Total                                                               |                          |                  |                |       | Added by _____<br>Checked by _____<br>Readded by _____                                                           |                        |
|                                                                                    |                          |                  |                |       | Signature of Clearing Member _____<br>All spaces below Totals (heavy line) for use of R. C. C. only              |                        |

Figure 43. Contingent Cleared Stock Balance List

the settlement day shows to what extent the given member will presumably incur liabilities in the ensuing actual money clearance and settlement.

**Non-Cleared Security Contingent Lists.**—The Day Branch also requires the submission to it of similar credit as well as debit contingent lists for all non-cleared security transactions, which in practice consist at present of all bonds and inactive stocks. But a somewhat different method of procedure is employed than with cleared security debit contingent lists. In physical appearance, contingent credit and debit lists for non-cleared securities are very similar to the debit contingent list for cleared securities already described; credit lists (see Figure 44) are printed in red and debit lists in black. For convenience of handling, however, contingent lists for bonds are of yellow paper, and for non-cleared shares of green paper.

We have seen<sup>4</sup> that for non-cleared security transactions made regular way, comparison is effected by the passage back and forth between deliverer and receiver of the so-called "three-way exchange ticket." At the conclusion of this comparison, the receiver holds one of their "deliver" portions, and the deliverer the other "deliver" portion and the "receive" portion.

We have also seen<sup>5</sup> that for bond transactions made "deferred delivery," a comparison on the contract is made by passing the "deliver" and "receive" bond contract tickets of the "four-way ticket" between deliverer and receiver, and that before delivery and settlement the other two tickets of the form—namely, those labeled "Delayed Delivery (Bonds)"—are again passed. Before the money clearance and settlement occurs, each deliverer therefore has in his possession the latter two forms, the "receive" form being signed by the receiver.

Both the signed deliver and receive tickets of the "three-way ticket" and the similar tickets of the "four-way ticket" not only serve as a means of effecting comparison, but also

<sup>4</sup> See Chapter XII, p. 319.

<sup>5</sup> *Ibid*, p. 319.



| Stocks not entered on previous Night Clearing Sheet                                                      |               |                       |       | Stock Clearing Corporation<br>DAY BRANCH   |                     |  |  |
|----------------------------------------------------------------------------------------------------------|---------------|-----------------------|-------|--------------------------------------------|---------------------|--|--|
| STOCK CLEARING CORPORATION (DAY BRANCH)                                                                  |               |                       |       | STOCKS                                     |                     |  |  |
| Contingent Credit List for value of Stocks to Deliver as per exchange tickets dated <u>July 2nd 1929</u> |               |                       |       | Failed to Deliver                          |                     |  |  |
| Stamp Name of Member <u>Jenkins &amp; Co.</u>                                                            |               |                       |       | Total value of which charge to our account |                     |  |  |
| Deliver to                                                                                               | No. of Shares | Stocks                | Price | Value Stocks                               | Value Failed Stocks |  |  |
| 1 <u>Rose &amp; Co.</u>                                                                                  | 100           | <u>Int. Brantford</u> | 140   | 14,000                                     |                     |  |  |
| 2                                                                                                        |               |                       |       |                                            |                     |  |  |
| 3                                                                                                        |               |                       |       |                                            |                     |  |  |
| 4                                                                                                        |               |                       |       |                                            |                     |  |  |
| 17                                                                                                       |               |                       |       |                                            |                     |  |  |
| 18                                                                                                       |               |                       |       |                                            |                     |  |  |
| 19                                                                                                       |               |                       |       |                                            |                     |  |  |
| 20                                                                                                       |               |                       |       |                                            |                     |  |  |
| 1                                                                                                        |               |                       |       |                                            |                     |  |  |
| 2                                                                                                        |               |                       |       |                                            |                     |  |  |
| 3                                                                                                        |               |                       |       |                                            |                     |  |  |
| 4                                                                                                        |               |                       |       |                                            |                     |  |  |
| 5                                                                                                        |               |                       |       |                                            |                     |  |  |
| 6                                                                                                        |               |                       |       |                                            |                     |  |  |
| 7                                                                                                        |               |                       |       |                                            |                     |  |  |
| 8                                                                                                        |               |                       |       |                                            |                     |  |  |
| 9                                                                                                        |               |                       |       |                                            |                     |  |  |
| 10                                                                                                       |               |                       |       |                                            |                     |  |  |
| 11                                                                                                       |               |                       |       |                                            |                     |  |  |
| 12                                                                                                       |               |                       |       |                                            |                     |  |  |
| 13                                                                                                       |               |                       |       |                                            |                     |  |  |
| 14                                                                                                       |               |                       |       |                                            |                     |  |  |
| 15                                                                                                       |               |                       |       |                                            |                     |  |  |
| 16                                                                                                       |               |                       |       |                                            |                     |  |  |
| 17                                                                                                       |               |                       |       |                                            |                     |  |  |
| 18                                                                                                       |               |                       |       |                                            |                     |  |  |
| 19                                                                                                       |               |                       |       |                                            |                     |  |  |
| 20                                                                                                       |               |                       |       |                                            |                     |  |  |
| 21                                                                                                       |               |                       |       |                                            |                     |  |  |
| 22                                                                                                       |               |                       |       |                                            |                     |  |  |
| 23                                                                                                       |               |                       |       |                                            |                     |  |  |
| 24                                                                                                       |               |                       |       |                                            |                     |  |  |
| 25                                                                                                       |               |                       |       |                                            |                     |  |  |
| 26                                                                                                       |               |                       |       |                                            |                     |  |  |
| 27                                                                                                       |               |                       |       |                                            |                     |  |  |
| 28                                                                                                       |               |                       |       |                                            |                     |  |  |
| 29                                                                                                       |               |                       |       |                                            |                     |  |  |
| 30                                                                                                       |               |                       |       |                                            |                     |  |  |

Jenkins & Co.  
Signature of Clearing Member

Added by \_\_\_\_\_

Checked by \_\_\_\_\_

Readied by \_\_\_\_\_

All spaces below Total (heavy line) for use of B.C.C. only.

Figure 44. Contingent Non-Cleared Stock Credit List

constitute orders upon the Stock Clearing Corporation to credit a member's account for the money value of securities which he delivers, and to charge his account for the money value of securities which he receives.

#### Checking of Non-Cleared Security Contingent Lists.—

It was pointed out<sup>6</sup> that the Night Branch, in the course of its security clearance, audits all Stock Exchange transactions in cleared securities. A comparable service is afforded transactions in non-cleared securities by the Day Branch.

Each morning each clearing member sends to the Day Branch his contingent lists for non-cleared securities, together with the exchange tickets for the items which they record. Clerks in the Day Branch check every item on every such contingent list against the signed exchange ticket for it sent in by the other party to the transaction. This process resembles the checking in the Night Branch of every member's "Night sheet" by the exchange tickets of the other parties sent in with it.<sup>7</sup> Due to it, the Stock Clearing Corporation is assured that every transaction in non-cleared securities has been compared and acknowledged by the two parties to it. The footings of the debit sheets are then checked, since these constitute the charges against members' accounts which will be made that day, subject to "failures to deliver." The contingent lists are passed to racks as they are checked, and then to the cages where the member accounts to which they apply are kept. Since non-cleared stocks are delivered through the Central Delivery Department, contingent lists for them are made out in duplicate and the extra copy is sent to the Central Delivery Department.

**Establishment of Contingent Credits and Debits.**—The cages where member accounts are kept obtain the contingent lists in cleared securities of their respective clearing members by 10 A.M. With each account, the total contingent credits as shown on the member's contingent credit lists are entered on

<sup>6</sup> See Chapter XII, p. 344.

<sup>7</sup> *Ibid.*, p. 337.

his record sheet in its "contingent credit" column, and similarly the total contingent debits from his debit list are put on his record sheet in its "contingent debit" column. In cleared securities, which are all delivered through the Central Delivery Department, only actual credit lists are used and therefore the only contingent items entered on the member's record sheet for cleared balances are debits.

By reason of these practices with the various kinds of contingent lists, the Stock Clearing Corporation is in a position to know to about what extent each of its members may be expected to participate in the day's money settlement, and is well prepared for its actual business of effecting a money clearance and settlement for its members.

As a preliminary assurance of accuracy, each cage makes a record of all stock balances contingently deliverable and receivable by members whose accounts are kept there, together with their resultant contingent money credits and debits. Total contingent credits for balances on cleared securities are obtained from the Night Branch while total contingent debits on cleared securities come to the Day Branch on the appropriate debit contingent lists for cleared security balances. The "Proof Department" of the Day Branch adds up total stock balances and their money values, for all clearing members. Total stock balances to deliver must of course equal total stock balances to receive,<sup>8</sup> and thus the money value of the one (or the contingent credits of all members) must equal the money value of the other (or the contingent debits of all members). If such is found to be the case, the accuracy of the contingent lists sent to the Day Branch is "proved." If the totals do not "prove," then there is opportunity for the Day Branch to run down the error in the contingent lists to its source, inform the respective members, and obtain corrected lists from them before the actual money clearance and settlement begins. The Stock Clearing Corporation will not undertake to make corrections of any kind on its own responsibility.

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<sup>8</sup> See Chapter XII, p. 338.

**Actual Entries on Members' Record Sheets.**—The work of money clearance performed by the Day Branch centers on the record sheets kept for its members in its eleven cages. As members establish credits, they are so entered there under "Actual Cr."—and as they incur debits these are similarly entered there under "Actual Dr."

Under the scope of operations which the Stock Clearing Corporation now enjoys, its members may be credited or debited on their record sheet accounts: (1) when security deliveries are made or received, in both cleared and non-cleared securities; (2) when security collateral loans are made, or when they are paid off, or their collateral is withdrawn from the cage; and (3) when special settlements are effected in "when issued" securities. Each of these sources for credits or debits on the members' record sheets must next be examined, to see just how they are established.

**Actual Credits and Debits for Security Deliveries.**—Before the establishment of the Central Delivery Department, the deliverer (as we have seen<sup>9</sup>) used to make his delivery of security certificates at the office of the receiving member, who thereupon signed both the "credit" and "charge" portions of the "delivery ticket." The deliverer's messenger then took these signed tickets to the receiving window of the Stock Clearing Corporation at 14 Broad Street; the time of its arrival there was stamped on the detachable stub of the "credit" ticket and given to the messenger as a receipt. (While the corresponding stub of the "charge" ticket was kept for delivery to receiving members, the latter rarely took the trouble to collect them, since such receiving members already had possession of the actual security certificates involved by the delivery.) The Corporation clerks, on receipt of the "credit" and "charge" delivery tickets, then tore them apart; the "credit" ticket was then sent to the cage where the delivering member's account was kept, and the "charge" ticket to that where the receiving

<sup>9</sup> See Chapter XIII, p. 347.

member's account was kept. The tellers in the former cage, on receipt of the "credit" ticket, entered an actual credit for the money amount of the securities delivered upon the delivering member's record sheet; in the latter cage, the "charge" ticket was similarly used to enter a corresponding debit item on the receiving member's record sheet.

This older method is still employed for securities which are delivered in the old way direct between the office of the deliverer and that of the receiver. But the establishment of the Central Delivery Department has greatly changed the procedure in respect to security deliveries which are made through it. We have seen<sup>10</sup> that a deliverer through the Central Delivery Department passes in at its receiving window an "actual credit list" and separate "charge tickets" for every item upon it, along with the security certificates which he is delivering. When the clerk at the receiving window has counted the securities, the second form of the actual credit list is sent to the particular cage in the Day Branch where the delivering member's account is kept. Since the securities are already in the possession of the Stock Clearing Corporation in their transit to the receiving member or members, the money value of the security deliveries on the list can be entered as an actual credit upon the delivering member's account. This use of the "actual credit list" makes for simplicity as compared with the older practice of establishing actual credits for security deliveries made item by item by the numerous credit forms of the "delivery ticket."

Meanwhile, the charge tickets remain with the security delivery in the Central Delivery Department until the receiving member's messenger obtains them there; before taking the securities away, the messenger signs a special charge ticket for each delivery on behalf of his firm.<sup>11</sup> The first form of these charge tickets is then sent into the Day Branch cage where the account of the receiving member is kept, and the money value of all such tickets is entered as debits upon his account.

<sup>10</sup> See Chapter XIII, p. 352.

<sup>11</sup> *Ibid.*, p. 357.



Through these methods, payment for securities delivered is effected on the members' accounts at the Stock Clearing Corporation, rather than by the passing of checks between them as was done prior to 1920. For every actual credit entered for a member, there must be a corresponding debit for some other member.

**"Failures to Deliver."**—Of course there is always a possibility that for some reason or other a delivering member may find it impossible to make a security delivery, either as a whole or in part. Under the rules of the Stock Exchange (Chapter IV) and of the Stock Clearing Corporation (Rule 32), the failure of a member to deliver or receive securities on regular-way contracts by 2:15 P. M. of the next full business day after contract, may result in the securities being "bought in" or "sold out." But if such a failure to deliver results from an agreement between the delivering and receiving member, it is considered that they have entered into a new contract on which they alone are liable, and under which the securities must be delivered and paid for directly between themselves and not through the Stock Clearing Corporation.

To the extent that such "failures to deliver" or "failures to receive" occur, the members' contingent lists of credits and debits established at their cages in the Day Branch will not, of course, agree with the actual credits and actual debits which are established there by security deliveries actually made. It is therefore necessary for members failing to deliver or to receive to notify the Stock Clearing Corporation, so that the failed transactions can be removed from their records in the Day Branch. For this purpose, contingent lists of all kinds are furnished with a perforated strip, upon which the amount and money value of the failed securities is entered as the Stock Clearing Corporation is notified concerning them. The strip can then be torn off the contingent list, and sent to the cage where the account to which it applies is kept.

In a sense, the six-day delivery method employed for bonds <sup>12</sup> represents a regularized failure to deliver the next full business day following that of negotiation, except that with them a recomparison occurs, and delivery and payment are finally made through the Stock Clearing Corporation.

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                        |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| Blotter Line No. <u>12</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                        |
| <b>STOCK CLEARING CORPORATION</b><br>(DAY CLEARING BRANCH)<br>TO BE DELIVERED BY TRANSFER                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                                        |
| Clearing No. <u>450</u><br><small>(Of Delivering Member)</small>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | New York, <u>August 4</u> 19 <u>29</u> |
| STOCK CLEARING CORPORATION (DAY CLEARING BRANCH),<br>ON STOCK BALANCE ORDER TO DELIVER.                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                        |
| To <u>C. E. Bowman &amp; Co.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                        |
| <u>100</u> shares <u>U. S. Rubber coin.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | @ <u>84</u> \$ <u>8,400.00</u>         |
| <p>The undersigned have agreed that delivery of above be made by transfer, subject to the rules of the Stock Clearing Corporation and upon its approval <u>Tompkins &amp; Co.</u><br/> <small>(Receiving Member)</small></p> <p>will hand you immediately after such delivery a certified check to your order for \$ <u>8,400.00</u> the value as stated above, of the stock placed in transfer. Debit and Credit tickets for the value of the delivery must accompany this order so that approval may be stamped thereon by Stock Clearing Corporation</p> |                                        |
| Deliverer Signs <u>C. E. Bowman &amp; Co.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                                        |
| Receiver Signs <u>Tompkins &amp; Co.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                        |
| <small>(These notices will not be approved after 1.15 P.M.)</small>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                                        |

Figure 45. Deliver-by-Transfer Ticket

**Delivery by Transfer.**—Another exception to the normal operations of the Day Branch sometimes occurs with stocks which are “delivered by transfer.” A delivering member will occasionally have stock in his possession which is due to be delivered to the receiving member, but which must be transferred before it is a good delivery. (The deliverer might, for example, have two registered share certificates of 50 and of 55 shares, while he has an even 100 shares to deliver.) In such cases, both delivering and receiving members may sign

<sup>12</sup> See Chapters X, p. 270, and XII, p. 319.

a special form (Figure 45) which states the number, name, price, and value of the shares to be delivered, and agree that this delivery shall be made by transfer subject to the approval of the Stock Clearing Corporation, and that upon this approval the receiving member will immediately hand to the Corporation a certified check to its order for the value of the stock placed in transfer. By rule of the Stock Clearing Corporation (Rule 8A), the Corporation must be notified by 10 A. M. if the delivery is to be made through the Central Delivery Department. In practice, however, deliveries by transfer through the Stock Clearing Corporation are very rarely made, since members prefer to "fail to deliver" and settle "ex-Clearing House."

**Actual Credits and Debits from Security Loans.**—The clearance of security loans by the Stock Clearing Corporation was described as a separate process in Chapter XIII. In actual fact, however, debits and credits on a clearing member's account arising from such loans are handled together with those arising from security deliveries and also other operations. It was pointed out<sup>13</sup> that clearing members may obtain credits on their Day Branch accounts by calling loans which they have made as lenders or contracting new loans as borrowers, and debits on their Day Branch accounts by making new loans as lenders or paying off old loans as borrowers. Before any such credits or debits can be established for their account at the Stock Clearing Corporation, however, the latter must be specifically ordered to do so on the appropriate forms by the clearing members in question. Chapter XIII has already described<sup>14</sup> how *credits* are established at the Stock Clearing Corporation for lending firms calling loans by the "pay-off loan credit tickets" (Figure 41a), and for borrowing firms contracting new loans by the "new loan credit tickets" (Figure 42a) or by the "new loan agreements" (Figure 40); in the

<sup>13</sup> See Chapter XIII, p. 361.

<sup>14</sup> *Ibid.*, p. 375.

same chapter it was also explained how *debits* were established at the Stock Clearing Corporation for lending firms making new loans by the "new loan charge tickets" (Figure 41b), and for borrowing firms paying off old loans by the "pay-off loan charge tickets" (Figure 42b) or by the "return loan agreements" (Figure 37).

As these different forms come to the cage where the given clearing member's account is kept, his account is respectively credited or charged in accordance with them, since the forms in each case are signed orders from him to the Stock Clearing Corporation.

#### **Actual Credits and Debits from "W. I." Settlements.—**

In addition to its regular settlements, the Stock Clearing Corporation sometimes effects special settlements; this is done usually with securities which are traded in upon the Stock Exchange "when, as, and if issued"—that is, before actual security certificates for the issue are available for delivery. Occasionally such trading "w.i." as it is called, may last for some time,<sup>15</sup> and under these circumstances daily deliveries of securities "regular way" are of course impossible. In order to avoid large open contracts and commitments from accumulating thereby, the Stock Clearing Corporation will settle such contracts by a final special settlement when security certificates become available for delivery, and meanwhile (if the "w.i." trading is sufficiently protracted and extensive) may conduct interim intermediate settlements and markings to the market. In either case, a settlement price is fixed, and contracts are cleared at this price. With any firm which has commitments in the "w.i." securities, there will be money differences between this settlement price to which the contracts are thus marked, and the actual prices at which the contracts were made on the Exchange. If a clearing member is in debit for such differences on his whole commitments, he pays the respective amount into his account at the Stock Clearing Corporation, while if

<sup>15</sup> See Appendix XIVb.

the member has a credit he can draw upon his account there for it. But as with other credits or charges on members' accounts there, the Stock Clearing Corporation must be in every case specifically ordered to perform this service for its members.

**Accommodation Allowed to Clearing Members.**—Against the possibility of insolvency on the part of a clearing member, the Stock Clearing Corporation has its "clearing fund," which is deposited on demand in various New York banking institutions and is thus always liquid and entirely at its immediate disposal. But with the exception of this "clearing fund," the Stock Clearing Corporation starts its operations each morning without a cent of money or a single security certificate in its members' accounts or its cages, and each evening ends its day's operations in the same position. All money which its members pay into the Corporation, and all securities which they deliver to it, are withdrawn from it by them the same day. The same basic situation of course obtains in all bank clearing houses; like them, the Stock Clearing Corporation is merely an agent of its members for the settlement of their contracts with each other.

Nevertheless, during the day the Stock Clearing Corporation may in fact extend considerable temporary accommodation to its members. For a clearing member may receive security deliveries faster or more extensively than he makes them, and in this way run up large debits on his Stock Clearing Corporation account which are not, temporarily at least, offset by the establishment on it of offsetting credits. Likewise, a clearing member may get the Corporation to pay off a collateral loan for him, and then rapidly or extensively withdraw the security collateral from his cage, thus leaving a large unsecured debit therefor on his account. In consequence, one of the most important tasks of the Corporation consists in vigilantly watching such temporary extensions of its credit to its members, and preventing them from becoming excessive.

The maximum amount of daily accommodation which the



Corporation will allow a given clearing member during the day is posted at the top of his "record sheet" at the beginning of the day. This amount ordinarily depends in each case upon the sum which the given member has contributed to the clearing fund; the minimum contribution to this fund is \$10,000 and is scaled upwards from this figure in proportion as the given member employs the services of the Stock Clearing Corporation more extensively. Thus, by a temporary additional contribution to the clearing fund, a member may temporarily obtain larger credit in proportion. From the promptly posted items on the member's record sheet, the officials of the Stock Clearing Corporation can obtain very quickly an exact statement of the member's position at any time during the day. If he is using excessive accommodation, they will at once demand of him, either that he at once establish new credits and postpone the establishment of additional debits in his account, or else that he send to the Corporation immediately his certified check for the amount by which the accommodation extended to him exceeds the sum allowed him by the Corporation. In this way, adequately safeguarded by its legal rights and its practical precautions, the Stock Clearing Corporation is able to impart a great flexibility to the whole stock settlement system by extending to its members temporary accommodation which they might otherwise have to seek at the banks in the form of unsecured "day loans"; thus the employment of such "day loans" has been extensively obviated by the Stock Clearing Corporation. In addition, by its especial ability to supervise, facilitate, and closely observe its members' daily delivery and settlement operations, the Stock Clearing Corporation is able, when the occasion requires, to safeguard and stabilize the whole settlement by on occasion halting the extension of unjustified accommodation to members, and by shortening the time during which it is employed.

**Money Clearance and Settlement.**—We have now pursued the complex process of settling Stock Exchange contracts

[illegible]

Showing final settlement of account of Jenkins & Co. Ruled lines at bottom of form are for securities to be withdrawn and are not involved in the present instance.

At the end of the day, each member's account on his "record sheet" (Figure 48) consists of two columns of items—one for actual credits and the other for actual debits in terms of money amounts. The money clearance performed by the Stock Clearing Corporation is very simply performed by adding up the total credits and the total debits of each member's record sheet, and then balancing these figures. If a member has total credits of \$500,000 and total debits of \$450,000, his account can thus be reduced to a final credit balance of \$50,000; if, on the other hand, another member has total credits of \$750,000 and total debits of \$850,000, he will have a final debit balance of \$100,000. Since in the Day Branch all credits and debits are

in terms of money, the process of clearing them is closely similar to that effected by bank clearing houses everywhere in the world.

There remains of course the final task of money settlement. This is accomplished with equal simplicity. Each clearing member ascertains whether his Stock Clearing Corporation account has a final credit or debit balance, and for how much money. He then fills out the final receipt (Figure 46). If a creditor he scratches out the word "check" and if a debtor the words "credit memorandum" upon it, and fills in the money amount of his final balance. If the clearing member has a final debit balance, he makes out his check to the order of the

|                                                                                                   |                                                                                                                                                                                                                      |                                                        |
|---------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------|
| For Account of<br><b>Jenkins &amp; Co.</b><br><small>PRINTED SIGNATURE OF CLEARING MEMBER</small> | <b>Stock Clearing Corporation</b><br>8 Broad Street<br>New York, July 2nd, 1929                                                                                                                                      | S.C.C. No. 400<br>\$6,033 <sup>33</sup> / <sub>4</sub> |
|                                                                                                   | Pay to the order of <u>Jenkins &amp; Co.</u><br><u>Six thousand thirtythree and <sup>33</sup>/<sub>4</sub></u> Dollars<br>To <u>Stock Clearing Corporation</u><br><u>Thirtieth National Bank. John Smith, Teller</u> |                                                        |

Figure 47. Draft on the Stock Clearing Corporation

Stock Clearing Corporation for its amount. If, on the other hand, the clearing member has a final credit balance, he draws a draft or credit memorandum for its amount against the Stock Clearing Corporation (Figure 47). The final receipt, together with the check or draft, is then dispatched to the Corporation. The receipt form is made out in duplicate; one part is retained by the Corporation, and the other is returned to the clearing member. The Corporation deposits the checks which come into it during the day, in the several banks with which it has accounts. On receipt of the drafts or credit memoranda drawn against it, in the course of the day's business, the Stock Clearing Corporation checks the amount of each against the mem-

ber's record sheet final balance, fills in the name of one of its depository banks against which it wishes to have the given draft presented, and the teller in the given member's cage then signs it in behalf of the Stock Clearing Corporation. The draft, thus made out, is then returned to the creditor clearing

|                    | No. <u>400</u> <u>Jenkins &amp; Co</u> Name of Clearing Member |     |    |                |        |            |
|--------------------|----------------------------------------------------------------|-----|----|----------------|--------|------------|
|                    | Dr. Contingent Cr.                                             |     |    | Dr. Actual Cr. |        |            |
| Cleared Stocks     | 21                                                             | 000 | 00 | 45             | 000    | 00         |
| Fails              |                                                                |     |    |                |        |            |
| Cleared Bonds      |                                                                |     |    |                |        |            |
| Fails              |                                                                |     |    |                |        |            |
| Non-Cleared Stocks | 35                                                             | 000 | 00 | 14             | 000    | 00         |
| Fails              |                                                                |     |    |                |        |            |
| Non-Cleared Bonds  | 2                                                              | 700 | 00 | 4              | 855    | 00         |
| Fails              | 2                                                              | 700 | 00 |                |        |            |
| Special Clearance  |                                                                |     |    |                |        | 5 391 91   |
| Fails              |                                                                |     |    |                |        |            |
| Bank Loans         |                                                                |     |    | 100            | 016 67 | 100 000 00 |
| Memo Loans         |                                                                |     |    | 100            | 016 67 | 100 000 00 |
| Central Delivery   |                                                                |     |    | 33             | 246 90 | 14 000 00  |
| Checks Drafts      |                                                                |     |    |                |        | 6 033 33   |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
|                    |                                                                |     |    |                |        |            |
| Suspense           |                                                                |     |    |                |        |            |
| Totals             | 61                                                             | 400 | 00 | 63             | 855    | 00         |
|                    |                                                                |     |    | 289            | 280    | 24         |
|                    |                                                                |     |    | 289            | 280    | 24         |

Figure 48. Clearing Member's Record Sheet

member, who can thereafter deposit it to his account in his bank, which in turn collects its proceeds from the depository of the Stock Clearing Corporation against whom it was drawn. And thus the complex processes of the Stock Exchange daily settlement system conclude.

Barring the eventuality of the insolvency of a clearing member, after every day's money clearance and settlement at the Stock Clearing Corporation, the total checks paid in on final debit balances will always foot up to exactly the same sum of money as the total drafts drawn against it on final credit balances of its members. In consequence, the managers and employees of the Stock Clearing Corporation Day Branch can shut up shop and go home about 6 P. M. each day with less continuing business worries than most of the denizens of the financial district.

**An Illustrative Day's Record Sheet.**—Figure 48 is made out to illustrate the record sheet of a commission house (Jenkins & Co.) for a typical Day Branch money clearance and settlement. For the sake of simplicity the items and amounts are made few and for small sums. Some of these items relate to transactions already described in this book.

From Night Branch balances, the contingent credit for \$45,000 (covering the prospective delivery of 300 Steel to Arnold Mitchell & Co.) is entered as a contingent credit. Other contingent credits consist of \$14,000 (for the prospective delivery of 100 National Biscuit preferred to Rose & Co.) and \$4,855 (for the prospective delivery of four French 7½% bonds to Brown & Co.); the latter two contingent credits are entered on the record sheet from contingent lists for non-cleared shares and for bonds. On the other hand, there is a contingent debit for \$21,000 on the delivery which Jenkins must receive of 200 Reading from T. Long & Co., one of \$35,000 for the delivery of 100 Otis Elevator to be obtained from Wilson & Co., and one of \$2,700 for the delivery of three City of Rome 6½% bonds to come from Gray & Co. All these items are entered on Jenkins' record sheet from contingent debit lists turned in to the Day Branch for cleared stock balances, for non-cleared stocks, and for bonds respectively.

Thus at the beginning of the day, the Stock Clearing Corporation knows that Jenkins & Co. on its security delivery busi-



ness will run up credits of approximately \$63,855 and debits of \$58,700. If "failures to deliver" occur, these figures will of course be altered in fact to that extent; just this, we will suppose, occurs with the \$2,700 debit item for the City of Rome bonds, which are therefore marked as "fails" on the record sheet. With this exception, all these contingent debits and credits become actual debits and credits during the ensuing day, as deliveries of securities are made.

But other items also enter the situation. Jenkins, we will suppose, decides to clear two \$100,000 loans through the Stock Clearing Corporation; the latter pays off the principal and interest of his old loans for him and debits him \$100,016.67 for each. Later, however, two new loans are made which result in the establishment of two \$100,000 credits.

Since one loan clearance was effected between banks, and the other between lending Stock Exchange members, the first is entered opposite "Bank Loans" in each case, and the second under "Memo Loans." In addition, Jenkins & Co. has sent securities worth \$14,000 to non-member banks through the Central Delivery Department, and has received from such banks through it \$33,246.90 of securities; these respective credit and debit items are entered opposite "Central Delivery." Finally, as the result of a special clearance of "when issued" security contracts, Jenkins & Co. obtains a credit of \$5,391.91.

Thus, at the end of the day, Jenkins' account shows total actual debits of \$289,280.24 and total actual credits of \$283,246.91. Jenkins therefore draws his final draft against the Stock Clearing Corporation for \$6,033.33 (Figure 47); the draft is signed by an official of the Stock Clearing Corporation and thus the money clearance and settlement of Jenkins' account in the Day Branch for that day is completed.

**Procedure with Insolvencies.**—Insolvencies of New York Stock Exchange members, and particularly of those who are clearing members of the Stock Clearing Corporation, have

become infrequent. Yet this unfortunate contingency must of course be provided for by the settlement system.

If a member becomes insolvent before turning in his "night clearance sheet" at the Night Branch, and thus involving his contracts in the process of security clearance, the Stock Clearing Corporation is not involved in his failure. Stock Exchange members proceed to "buy in" securities which the insolvent has sold them, and "sell out" securities which he has bought from them. If money losses result from this process, they constitute claims by these members against the assets of the insolvent. On the other hand, should profits result, these would be paid over to the insolvent. In this way, all contracts entered into with fellow Exchange members by the insolvent would be settled "ex-Clearing House" and without involving the resources either of the Stock Clearing Corporation, or its clearing members as such.

But if the member's insolvency is announced after his "night clearing sheet" has entered into the security clearance, all securities deliverable to or deliverable by the clearing member in accordance with security balance orders of the Stock Clearing Corporation are immediately sold out or bought in on the floor of the Stock Exchange by the parties having them to deliver to the insolvent or receive from the insolvent.

If a profit results from the selling out or the buying in of securities deliverable to or deliverable by the insolvent clearing member under a security balance order, the clearing member realizing such profit at once sends a statement of the transaction to the Stock Clearing Corporation and pays over the profit to it for the account of the insolvent member.

If a loss results from the selling out or the buying in of securities deliverable to or deliverable by the insolvent clearing member under a security balance order, the clearing member sustaining the loss at once sends a statement of the transaction to the Stock Clearing Corporation which pays him the amount

of the loss after the collection by it of the pro rata assessments against the original contracting parties.

**Odd-Lot Clearance and Settlement.**—Thus far, two stubborn obstacles have prevented the expansion of the Stock Clearing Corporation into the field of clearing and settling odd-lot transactions. The first of these relates to the great office space which the work would require. It must be remembered that to a stock clearing system, the number of separate transactions rather than their size is the determining factor in operations. Now odd-lot transactions, although they constitute roughly 30% of the total shares sold on the Exchange each day,<sup>16</sup> are probably even more numerous than round lot transactions. Thus, the undertaking to provide quarters for their clearance and settlement is a forbidding one, particularly in the Wall Street district—the most congested section in the whole world.

A second obstacle consists in the factor of expense. Presumably the economies effected by central clearance and settlement per share handled would be smaller with odd-lot than round lot transactions, while the overhead expenses entailed by the work would necessarily be heavy. Yet, as matters stand, odd-lot houses clear such trades for brokerage firms on their sheets without service charges.<sup>17</sup> It is therefore somewhat difficult to persuade the stockbroker to pay fees to a stock clearing house for clearance and settlement of odd-lot transactions which at present he obtains for nothing from the odd-lot houses themselves.

**Services of the Stock Clearing Corporation.**—The specific benefits derived by the financial community from the several species of operations performed by the Stock Clearing Corporation can now be summarized briefly.

I. By supervising the process of comparisons, what amounts to an audit is made of practically all transactions effected on the Stock Exchange, resulting in the speedy discovery

<sup>16</sup> See Chapter IX, p. 252.

<sup>17</sup> *Ibid.*, p. 251.

and composition of misunderstandings concerning contracts between members.

2. By clearing transactions in the most active securities, about 50% of the security deliveries otherwise necessary are obviated.

3. By installing facilities for central delivery, important savings of time, labor, and overhead expense are effected for members and for New York banks.

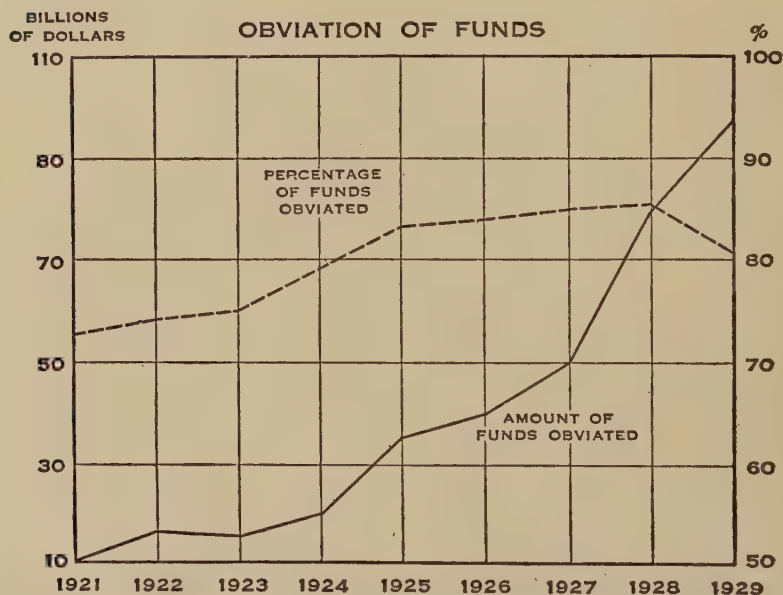


Figure 49. Annual Obviation of Banking Accommodation by the Stock Clearing Corporation

4. By issuing transfer and exchange receipts, sometimes large amounts of stocks and bonds are rendered liquid and assignable even when the certificates themselves are in transfer.

5. By the clearance and settlement of securities and money, huge savings in the use of banking accommodation are made (Figure 49).<sup>18</sup> In consequence, the need of Exchange members to secure temporary accommodation at the banks in the

<sup>18</sup> See Appendix XIVc.

form of unsecured "day loans" is greatly reduced. In addition, the stock market is not warped out of its normal economic functions by an insufficiency of bank accommodation.

6. Such large economies in labor are effected that the Stock Clearing Corporation can justly be considered one of the leading labor-saving devices in American finance. Under prevailing conditions in Wall Street, employees can be paid more because fewer and more intelligent workers are required.

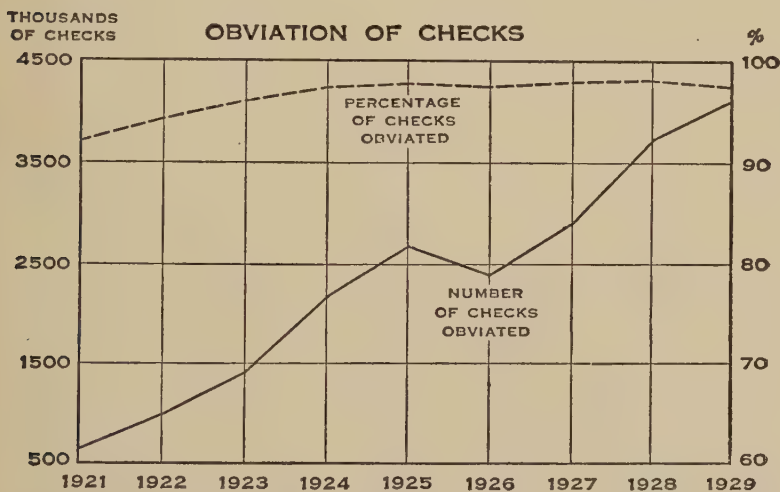


Figure 50. Annual Obviation of Number of Checks by the Stock Clearing Corporation

7. The above economies effected by the Stock Clearing Corporation, plus the keen and constant supervision it gives to the whole settlement process, have the effect of greatly speeding up all these operations. Any settlement system can in a sense move only as rapidly as its slowest member, but if there is some one to detect and stimulate its slowest units, all the more efficient units are safeguarded thereby from delay.

8. As one conspicuous item, the huge obviation of the number of separate checks which need to be drawn (Figure 50)<sup>19</sup>

<sup>19</sup> See Appendix XIVd.



results in economies not only to Stock Exchange firms but also to the banks, the Bank Clearing House and the whole money market.

9. Finally, the whole business of Stock Exchange firms is standardized, regularized, safeguarded, and placed upon a scientific and impersonal basis—one of the supreme accomplishments of highly organized markets.<sup>20</sup>

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<sup>20</sup> See Chapter II, p. 41.

## CHAPTER XV

### THE COMMISSION HOUSE

**Importance of the Commission House.**—The head offices of New York Stock Exchange stock brokerage firms are for the most part confined to the Wall Street district, although a considerable number of firms are located entirely outside of New York City. But owing to the establishment of a huge network of private wires reaching out from the commission houses of Wall Street to their branch offices and correspondents in all parts of America,<sup>1</sup> Stock Exchange brokerage offices are now to be found all over the nation. The Stock Exchange of today is a national market, meeting national needs and available for instant service to Americans over our whole vast national area.

Since it is through the commission houses, whether their head offices in Wall Street or their branch or correspondents' offices scattered from upper Manhattan to California, that orders from the American investing and speculating public are relayed to the Stock Exchange floor, the commission broker's office is an integral and extremely important part of the whole Exchange system. Indeed, much of the most difficult and necessary work of marketing listed securities is done in the hundreds of commission houses all over America, and even abroad. We must therefore give some time and attention to the problems, the methods, and the typical activities of the commission house, if we are to gain an adequate conception of the work and true significance of the Stock Exchange.

Almost everyone has seen the outside of a commission

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<sup>1</sup> See Chapter II, Figure 2.

brokerage office, whether in the lofty cliff dwellings of the Wall Street district, or elsewhere in the United States. In the banking section of even small American cities one can almost invariably discover a brokerage office, built sometimes of cut stone like a small bank, or, if less ostentatious, with its green silk window curtains, and its stereotyped legend in gold letters,

JENKINS & Co.

Members of the New York Stock Exchange

Not so many people, however, are equally familiar with the detailed methods by which business is transacted there.

All commission houses are partnerships, at least one of whose partners is a member of the New York Stock Exchange. Corporations are not permitted to own a seat there.<sup>2</sup> But a considerable difference, of course, exists between the various commission houses in the scope and variety of the service they render the public. There are also fundamental differences between the main office and its branch or correspondents' offices beyond the Wall Street area. In order that we may see as much as possible of the brokerage house machinery, we will elect to visit the main office of a fairly large commission house located at 500 Wall Street.

**Appearance of a Typical Commission Office.**—As we enter the outer door we may see several windows marked "Cashier," "Telegrams," and "Deliveries." But since we are neither messenger boys nor stock runners, we enter the customers' room.

The first item of furniture which usually strikes our eye is the large quotation board on the wall, although some firms do not employ one. Some brokerage offices still prefer the older type of quotation board, which consists simply of a large black-board upon which current prices are chalked, while others favor the oak or mahogany board with cardboard tickets. This latter type of board is equipped with horizontal ledges in which

<sup>2</sup> See Appendix XVIa.

green cardboard price tickets printed with black figures are inserted. The record of the active stocks which the board contains, runs vertically, giving the highest, lowest, and last current quotations for the day. Above each individual stock record is usually a red plate, containing the ticker symbol of the given stock in white letters, as well as its latest dividend rate. On one side of the board (if the house executes orders in other stock or produce markets) is a space for stocks listed only on out-of-town exchanges, and for such speculative and staple commodities as cotton, wheat, corn, pork, sugar, etc., etc.

The "board boy"<sup>3</sup> ceaselessly paces up and down in front of the board, changing the latest quotation by inserting new cards, as new prices are called out to him by another employee of the house standing beside the stock ticker, to one side of the board. This latter instrument, together with the somewhat similar news tickers containing a record of the latest announcements and events occurring all over the world, fill the room with a low metallic stuttering. Thus the spectator can see easily and quickly just what the various markets are "doing."

**Difficulties of Financial Abbreviation.**—But to read stock quotations, considerable technical knowledge is necessary. The various stocks are each indicated, not by their full titles, but by a system of abbreviations or symbols which the exigencies of time and space—both precious in Wall Street—make necessary. Some symbols are obvious enough—even the amateur might suspect that "PA" indicated the Pennsylvania Railroad. But most stock symbols are more difficult to identify than this, and before they all become at once recognizable constant reference must be had to the explanatory list of symbols hung near the stock ticker. The amateur's difficulty is only increased by the hasty and unintelligible explanations given him by experts. If he asks to what stock "MN" may refer, he will probably be told "Mexican Pete," which is not the sobriquet of some southwestern desperado but an abbreviated

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<sup>3</sup> See Appendix XVa.

way of saying "Mexican Petroleum." But in time he too will learn to refer to the Atchison, Topeka & Santa Fe Railway (A) inelegantly but concisely as "Atch," or the Missouri, Kansas & Texas Railroad (KT) as "Katy." This queer and sometimes fantastic slang used in brokerage circles undoubtedly saves valuable time, and is convenient, practical, and simple enough—once it is understood.

**Departments of the Commission House.**—Facing the stock board are several rows of armchairs where the customers of the firm can sit and watch the fluctuations in prices shown on the board. Close at hand to the customers' chairs is the order department, which handles the execution of such orders as the customers in the office may tender it, and such telephoned, telegraphed, or written orders as come in to the firm. Nearby is the cashier's cage, in many ways the real executive center of the office. In adjoining rooms are the private offices of the firm partners, the accounting department where the firm's bookkeepers work, and perhaps an unlisted department, which handles orders for securities not listed upon the Stock Exchange, and which usually consists of a desk, a telephone, a few financial manuals, and one of the quickest and most incisive brains in the office.

In addition, there is the statistical department, which often carries on general financial educational and publicity work, prepares special reports for the firm or its customers on various financial topics, issues circulars and market letters, and performs a variety of other practical and necessary routine work for the firm. The educational work done by Stock Exchange brokerage offices all over the country is valuable from a national standpoint, since it acquaints the public with current economic problems and makes available everywhere information regarding investments—a significant service when the ignorance of many investors and the persistence of clever and daring stock swindlers are remembered.



**The Romance of Gauging the Future.**—There are few more fascinating aspects of the modern business world than that revealed to the thoughtful spectator of the stock board. As one sits in the customer's chair, he is, through the news ticker, placed automatically in touch with the latest news of the world—news which the linotype batteries of the great metropolitan papers have not yet even started to cast into columns and pages. But the stock board itself goes even this instantaneous news service one better, for the ever-restless and ever-changing security prices which it records are the estimates in dollars and cents of future rather than present conditions in the whole country's industry and trade. The hopes, the fears, the aspirations, and dreams and dreads of the whole nation thus find an expression here in the ceaseless fluctuations of stock prices.

The sheer romance of this constant attempt to discount the future which causes much of the price fluctuation in speculative stocks makes a particularly strong appeal to the imaginative mind, for the thoughtful student of modern society and civilization can see in it the true significance of the stock market as a barometer of the future. Many hard-headed American business men who never engage in marginal transactions in securities, nevertheless follow the course of stock market prices very closely in order to foresee the probable future tendencies of their own particular business.

But the commission broker, being of necessity an eminently practical man, can scarcely be expected to maintain expensive offices, engage numerous highly trained technical employees, buy a Stock Exchange seat, obtain extensive credit facilities at the banks, and undergo constant business risks, merely for the philosophic pleasure of furnishing amusement to day-dreaming students of industry and trade. Although brokers sometimes speculate in securities themselves, their business consists primarily in earning commissions on their customers' orders. Let us see exactly how this is done.

Perhaps the simplest way to describe the operations occurring in a typical broker's office is to follow a transaction of a single customer from beginning to end. In an earlier chapter<sup>4</sup> this method was in part employed. But at that time many details of the typical transaction cited were omitted, since they involved technical procedure still unexplained.

**Opening a Brokerage Account.**—Accordingly, we will suppose that Mr. Blank has for the first time found his way into the customers' room of Jenkins & Co.'s main office at 500 Wall Street. Before he can buy or sell any securities there, however, he must open an account with the firm, a proceeding which closely resembles opening a bank account. Usually the customer will be personally introduced to the broker by a mutual acquaintance, and will then be given a card upon which to fill out his name, address, and present occupation. In some brokerage houses the prospective customer is also requested to sign an agreement that he will maintain with his broker sufficient margin on his account, and that in the event of his failure to respond promptly to a call for additional margin the brokerage house is authorized to take such action as it may deem necessary to protect its interests. Granted of course proper personal responsibility, the Exchange is open to all Americans on an absolutely equal footing.

As a necessary consequence to opening his account, Mr. Blank deposits with Jenkins & Co., say, five \$1,000 Atchison, Topeka & Santa Fe R. R. general 4% bonds, 40 shares of Pennsylvania R. R. stock, and his check for \$8,000—or about \$15,300 altogether—to provide margin for such transactions as he may later desire to enter into. The value of the securities thus deposited as margin does not, however, serve to reduce the customer's debit balance with the firm. Some commission houses frown on accepting security collateral for marginal purposes, although the practice is sufficiently extensive to justify the above example.

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<sup>4</sup> See Chapter VI.

Blank may next ask the broker to tell him which securities he should buy. Such questions place the broker in a delicate position. He may reply that he will take no "discretionary orders," meaning that he does not care to assume the responsibility of having the customer's orders left to his discretion. The broker's unwillingness to "handle his customer's account" is natural enough, for the broker is, after all, merely the customer's agent, and it is consequently the broker's business to take orders, not to give them. Furthermore, he cannot guarantee to have a more accurate idea of security values than the customer himself. But, as a compromise, he will usually express his opinion upon the various securities which the customer may name, or will himself indicate securities which in his opinion deserve special consideration.

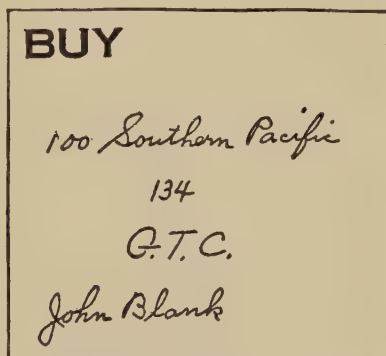


Figure 51. Office Buy Slip  
Containing Mr. Blank's order to buy  
100 Southern Pacific at 134, good till can-  
celed.

**Giving a Buying Order.**—During the ensuing week Blank decides to purchase 100 shares of the Southern Pacific R. R. Co. He might, of course, simply write or telegraph or telephone his order to the brokerage office. But in order to visualize the course of his order more concretely, let us suppose that he goes to the office of Jenkins & Co. a few days after opening his account with the firm and, having watched the board for a while, fills out an order blank (Figure 51) for the 100 shares of Southern Pacific. This order blank instructs Jenkins & Co. to purchase the stock, as the customary phrase goes, for his "account and risk." Blank may, of course, put a time limit upon this order, or mark it "G.T.C." (good till countermanded); he may likewise make a limited order of it by

placing a price upon the slip at or under which he is willing to purchase the stock, or he may leave it a market order to be executed at the prices prevailing in the market at that time. Market orders, of course, never have a time limit placed upon them. These various limitations placed by customers upon their orders have already been sufficiently outlined in an earlier chapter.<sup>5</sup> In this particular case, let us suppose that Blank marks his order "G.T.C." and puts a limit upon it at 134.

**The Necessity for Maintenance of Margins.**—Since the broker is merely the agent of his customers and cannot share in any profits which they may make in their purchases and sales of securities, naturally he cannot be expected to share with them any losses which they may experience. But, as we have seen,<sup>6</sup> the commission house contracts for the purchases and sales of securities which its customers may direct, in its own name, and other similar purchasing and selling houses, aided by the Stock Clearing Corporation, will hold it very strictly to account for the payment of money or the delivery of stock called for by these contracts. When the market moves adversely to his customers' interests, and when in consequence his customers' margins tend to diminish and expose him to risk, the broker will therefore, by the terms of the agreement between him and his customers, demand additional margin from them in order to protect himself against incurring losses on their accounts. If a customer does not respond to such a call for more margin within a reasonable time, then by the terms of the same agreement the broker is authorized to close out the account of his customer, by selling the latter's long stock or buying in the stock of which he is short.

The soundest and most conservative brokerage practice favors strict insistence upon "margin calls," and disagreeable though such a call may sometimes be to a customer, he should respect his broker all the more for his promptness in demanding more margin. On the other hand, the best interest not only

<sup>5</sup> See Chapter VI, p. 159.

<sup>6</sup> See Chapter XII, p. 312.

of brokerage houses and banks, but also of the given customer himself and other similar customers, requires a prompt response by him to calls for more margin.

**The Pledging of Customers' Securities.**—The marginal customer must also agree that all securities purchased and carried on margin for him by his broker, or those deposited as margin on his account, may be loaned by the broker, or may be pledged by him, either separately or together with other securities, without further notice from the broker.<sup>7</sup> Except for the constant hypothecation at the banks of securities purchased on margin by customers, the broker would be unable to extend credit to his customers and enable them to purchase on margin.<sup>8</sup> But securities which the customer has purchased outright and has left in his broker's hands, cannot be pledged for loans in this way without the customer's consent, since they are entirely the customer's property, unless of course they have been used to furnish margin on the customer's account.

Blank's order for 100 Southern Pacific, let us suppose, is limited to the price of 134, and is marked "G.T.C." He hands it through the window to the order clerk, who telephones it to the Stock Exchange over the firm's private wire direct to the floor. The order is received there at the firm's telephone booth, and given by the telephone clerk to the firm's floor broker, who at once goes to the Southern Pacific post, executes the order,<sup>9</sup>

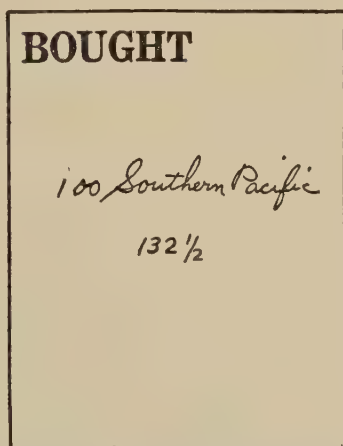


Figure 52. Office Purchase Report Slip

Containing report of purchase of stock for Mr. Blank.

<sup>7</sup> See Appendix XVb.

<sup>8</sup> See Chapter XI, p. 282.

<sup>9</sup> See Chapter VI, p. 162.



and so informs the telephone clerk, who in turn reports the purchase back to the order clerk in the office (Figure 52). Simultaneously, the reporters on the floor have "caught the sale" and turned it in to the Quotation Company; perhaps before the order clerk has been notified that the sale has been effected, Blank may see the brief but confirmatory message "SX 132½" (or perhaps in still more abbreviated form "SX 2½"), appear on the stock ticker in Jenkins & Co.'s office. But Blank must not jump to the conclusion that such a price on the tape will necessarily represent the purchase of his own stock, for reasons previously stated.<sup>10</sup>

**The Commission House Machinery in Motion.**—When he first receives the order, the order clerk stamps the time of its receipt upon it, in order to be able to run down any possible future questions about its execution, and files it alphabetically. When the report of its execution is received from the Exchange, the order clerk pulls out the order blank again, marks upon it the price at which the purchase was made, and again stamps it to check the time at which it was executed. In most offices the order is then listed on triplicate forms in order to provide the accounting, clearing house, and report departments of the brokerage house with a record of the purchase. The report department at once makes up a memorandum of the purchase (Figure 53), which states from what Exchange member the 100 Southern Pacific was purchased, as well as the price, the date of the purchase, and other data. This memorandum,<sup>11</sup> commonly known as a "confirmation," is at once dispatched by mail to the customer's address. The accounting department, on receipt of its copy of the order form, enters the item on Mr. Blank's account with the firm, and the margin clerk carefully revises the figure of Blank's present margin.

Lastly, the clearing house department enters the item of the 100 Southern Pacific purchased on the firm's clearing house

<sup>10</sup> See Chapter IX, p. 247.

<sup>11</sup> See Appendix XVc.

blotter (since transactions in Southern Pacific stock are regularly cleared).<sup>12</sup> That evening, when Jenkins & Co. makes up its balance or clearance sheet to send to the Night Clearing Branch, the item of 100 Southern Pacific appears as stock to be received. If Blank's transaction was the only one handled that day by the firm in this particular stock, it will on the mor-

| JENKINS & Co.,<br>500 WALL ST.                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                         |       |      |                            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-------|------|----------------------------|
| New York, <u>August 5<sup>th</sup></u> 19 <u>29</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                         |       |      |                            |
| <u>Mr. Blank</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                         |       |      |                            |
| We have this day <b>BOUGHT</b> for your account and risk, in accordance with the rules of the New York Stock Exchange.                                                                                                                                                                                                                                                                                                                                                                                   |                         |       |      |                            |
| NO. SHARES                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | DESCRIPTION             | PRICE | TIME | FIRM NAME                  |
| 100                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | <i>Southern Pacific</i> | 132½  | 2.03 | <i>Jefferson &amp; Co.</i> |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                         |       |      |                            |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                         |       |      |                            |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                         |       |      |                            |
| It is agreed between broker and customer:<br>1. That all transactions are subject to the rules and customs of the New York Stock Exchange and its Clearing House,<br>2. That all securities carried from time to time in the customer's marginal account, or deposited to protect the same, may be loaned by the broker, or may be pledged by him, either separately or together with other securities, either for the sum due thereon or for a greater sum, all without further notice to the customer. |                         |       |      |                            |
| Respectfully yours,<br><b>JENKINS &amp; CO.</b><br>By <u>William Jones</u>                                                                                                                                                                                                                                                                                                                                                                                                                               |                         |       |      |                            |

Figure 53. Broker's Confirmation

Showing purchase by Jenkins & Co. of 100 Southern Pacific at 132½ from Jefferson & Co. at 2:03 P.M.

row obtain from the Night Clearing Branch in its statement of "stock balances to receive" instructions to receive 100 Southern

<sup>12</sup> See Chapter XII, p. 328.

Pacific from some designated Exchange member. The stock is paid for by Jenkins & Co. under the supervision of the Day Branch described in a previous chapter.<sup>13</sup> The 100-share certificate, when received, may be put in a loan envelope by the cashier and sent to the Forty-first National Bank of New York as collateral for a loan;<sup>14</sup> or may be loaned to some other broker who has sold this amount short and wishes to make a delivery to his purchaser.<sup>15</sup>

|                                                                                                   |
|---------------------------------------------------------------------------------------------------|
| <p><b>SELL</b></p> <p><i>100 Southern Pacific</i></p> <p><i>Mkt.</i></p> <p><i>John Blank</i></p> |
|---------------------------------------------------------------------------------------------------|

Figure 54. Office Sell Slip  
Containing Mr. Blank's order to sell  
100 Southern Pacific "at the market."

|                                                                         |
|-------------------------------------------------------------------------|
| <p><b>SOLD</b></p> <p><i>100 Southern Pacific</i></p> <p><i>135</i></p> |
|-------------------------------------------------------------------------|

Figure 55. Office Sale Report Slip  
Containing report of sale of stock for  
Mr. Blank.

**Sequel to a Margin Purchase.**—But sooner or later Blank will either sell out this stock at a profit or loss (see Figures 54 and 55), or else pay up what he owes upon it and "take it up," to hold outright as an investment. If Jenkins & Co. have loaned the certificate to some other broker, they may request its return, upon which they will return to the borrower its money equivalent which he loaned them in exchange for it, and deliver the stock to Blank, or to some other firm to whom they have sold it upon his subsequent instructions. If Blank's stock is reposing in a loan envelope at the bank, Jenkins & Co. may

<sup>13</sup> See Chapter XIV.

<sup>14</sup> See Chapter XI, p. 282.

<sup>15</sup> See Chapter VII, p. 187.

substitute some other equally valuable security or securities in place of it, obtain the certificate, and deliver it to Blank,<sup>16</sup> on receipt of his check for the sum which he still owes upon it.

**The Practice Regarding Transfers.**—One frequently troublesome detail, however, has been disregarded in the above operations—the matter of transfer.<sup>17</sup> So long as a share certificate is irrevocably assigned by a Stock Exchange house, it constitutes a good delivery. Hence, stock held by a firm on marginal account for its members, if so assigned, may be made out in the name of any firm, and still be readily salable or constitute satisfactory collateral for a loan. If the stock is non-dividend-paying, there is little purpose in having it retransferred every time it changes hands. But if it pays dividends, they will, of course, be paid to the firm or individual in whose name the stock stands. In consequence, it is customary for firms holding stock on margin account to have it transferred into their own name before the corporation books close for dividends, in order to receive the dividends accruing on the stock. The brokerage firm can still borrow money upon a stock in transfer, however, if it turns the certificate in at the Transfer Department of the Stock Clearing Corporation and obtains in exchange for it an assignable transfer receipt.<sup>18</sup>

Ordinarily, bonds are sold with accrued interest added to the selling price.<sup>19</sup> In the case of dividend-paying stocks, as the day approaches when the books of a corporation are closed for the payment of a dividend, the stock tends to sell at a higher price which roughly equals its regular price at that period, plus the dividend about to be paid. Once the books are closed, however, the new purchaser of the stock will not receive the dividend, which will go to the holder of the stock at the time when the books were closed. Hence, the amount of the dividend to be paid is promptly subtracted from the price of the stock,

<sup>16</sup> See Chapter XI, p. 294.

<sup>17</sup> See Chapter I, p. 26.

<sup>18</sup> See Chapter XIII, p. 380.

<sup>19</sup> See Chapter X, p. 267.

which under such circumstances is said to sell "ex-dividend." Sometimes, however, in strong bull markets, when stock prices are rising swiftly, the price of the given stock may rise sufficiently to offset the amount of the dividend. In such a case the subtraction of the dividend would not be revealed in the current price of the stock.

**Functions of the Cashier.**—The cashier of a brokerage firm is in many respects the practical executive of the office and supervises its entire routine. It is he who borrows money on the firm's stock, either at the banks or on the Exchange, who deposits money at the banks and checks it out again, and who oversees the receipt and delivery of the firm's daily stock balances. It is natural that many cashiers ultimately become partners in their firms, and that many governors of the Stock Exchange have in their younger days served their apprenticeship in the cashier's cage.

**The Bookkeeping Side of Stock Brokerage.**—But we are getting far afield from the office of Jenkins & Co. at 500 Wall Street. While Blank and other customers of the firm have been ordering the purchase and sale of securities, the bookkeeping or accounting department of the firm has not been idle. We have already seen that a copy of every order received by the order clerk is dispatched at once to this department, where a prompt record of every customer's account is kept. Thus Blank can obtain an accurate and detailed statement of his account with the firm any time he asks for it. Few visitors to Wall Street have any conception of the importance or the amount of bookkeeping which Stock Exchange work necessitates. But for the army of bookkeepers which invades the financial district early each morning, and does not leave until the accounts of the various houses are completed for the day, the whole system would at once break down. Even a moderate-sized brokerage house must employ a large bookkeeping force



to handle accurately and promptly the almost infinite detail of the day's business.

Since, therefore, the broker's bookkeeper is so fundamental in the machinery of the Stock Exchange system, it were well to inspect a typical piece of his handiwork. Brokerage houses at stated intervals render statements to their customers of their accounts, as well as at any time when the latter demand them. These statements of the customer's account must not, of course, be confused with the confirmation of each particular transaction which, as has been noted, is sent to the customer as soon as possible after the execution of the order which it reports. Commission houses also make it a practice promptly to send notices to their customers of any dividend paid on stocks in their accounts, with a credit if it is long stock and a debit if it is short stock.

**The Customer's Statement.**—In practice, there is considerable diversity in the exact form of the statements which stock-brokers render their customers, although most firms today have succumbed to the superior efficiency of the more modern book-keeping machines. The precise form of the statement employed by a given Stock Exchange firm also depends to a considerable extent upon the particular sort of business it does—whether for many or few customers, or whether localized or nationwide. The example of the customer's statement introduced here (Figure 56) was selected not so much because it was typical (for it probably is not), as because it sets forth the facts completely and in a manner more readily understood by the layman.

Customers care so little for the detailed interest statement composing the right-hand side of the illustration, that brokers often send this only when requested to do so; frequently, therefore, this interest statement is made out on a perforated slip which is detached from the statement, and sometimes on an entirely separate form. Leaving this matter of interest in abeyance for the time being, let us first glance at the statement

| IF THIS ACCOUNT IS NOT CORRECT, PLEASE ADVISE IMMEDIATELY |                    |                   |                   |         |           |           |           |        |      | E. & O. E.                                                                                    |      |          |       |
|-----------------------------------------------------------|--------------------|-------------------|-------------------|---------|-----------|-----------|-----------|--------|------|-----------------------------------------------------------------------------------------------|------|----------|-------|
| John Blank<br>13 Forest St., N. Y. City                   |                    |                   |                   |         |           |           |           |        |      | IN ACCOUNT WITH JENKINS & CO.<br>MEMBERS NEW YORK STOCK EXCHANGE<br>500 WALL ST.,<br>NEW YORK |      |          |       |
| INTEREST STATEMENT                                        |                    |                   |                   |         |           |           |           |        |      |                                                                                               |      |          |       |
| DATE                                                      | BOUGHT<br>RECEIVED | SOLD<br>DELIVERED | STOCK OR BOND     | PRICE   | DEBIT     | CREDIT    | BALANCES  |        | DATE | BALANCE<br>FOR<br>INTEREST                                                                    | DAYS | INTEREST |       |
|                                                           |                    |                   |                   |         |           |           | DEBIT     | CREDIT |      |                                                                                               |      | DR.      | CR.   |
| Aug 8                                                     |                    |                   | Checks            |         |           | 8,000.00  |           |        |      |                                                                                               |      |          |       |
|                                                           | 40                 |                   | Pennae.           | 80 1/2  |           |           |           |        |      |                                                                                               |      |          |       |
|                                                           | 5 sh.              |                   | Atchafalpa Bond   |         |           | 8,026.00  |           |        |      |                                                                                               |      |          |       |
|                                                           | 100                |                   | Cal. St.          | 80 1/2  |           |           |           |        |      |                                                                                               |      |          |       |
| 5                                                         | 100                |                   | Reading           | 114 1/2 | 11,475.00 |           |           |        | 2    | 3,471.00                                                                                      | 3    | 1.74     |       |
| 7                                                         |                    |                   | So. Pacific       | 132 1/2 | 13,275.00 |           | 8,724.00  |        | 5    | 16,730.00                                                                                     | 2    | 5.59     |       |
| 9                                                         |                    | 100               | So. Pacific       | 135     |           | 13,471.00 |           |        | 7    | 3,279.00                                                                                      | 2    | 1.10     |       |
|                                                           |                    |                   | Div. Reading      |         |           | 100.00    |           |        | 9    | 13,999.00                                                                                     | 7    | 3.70     |       |
| 16                                                        |                    |                   | Div. Cal. St.     |         | 50.00     |           |           |        | 16   | 3,229.00                                                                                      | 6    | 3.23     |       |
| 22                                                        | 100                |                   | Cal. St.          | 81 1/2  | 8,145.00  |           | 15,873.00 |        | 22   | 15,873.00                                                                                     | 4    | 10.58    |       |
|                                                           |                    |                   | Balt. & Ohio      | 12 1/2  | 12,525.00 |           |           |        |      |                                                                                               |      |          |       |
| 26                                                        | 100                |                   | Penn. R.R.        | 55 1/2  | 5,530.00  |           |           |        | 26   | 21,453.00                                                                                     | 3    | 10.73    |       |
|                                                           |                    |                   | Quicksilver Steel | 109 1/2 |           | 10,883.50 | 10,569.50 |        |      |                                                                                               |      |          |       |
| 29                                                        | 100                |                   | Quicksilver Steel | 103 1/2 | 10,350.00 |           |           |        | 29   | 20,994.50                                                                                     | 2    | 7.00     |       |
|                                                           |                    |                   | Penn. R.R.        |         | 75.00     |           | 20,994.50 |        |      |                                                                                               |      |          |       |
|                                                           |                    |                   | Interest 6 1/2%   |         | 54.59     |           | 26,049.09 |        |      |                                                                                               |      |          |       |
| 31                                                        |                    |                   | Balance           |         |           |           |           |        |      |                                                                                               |      |          |       |
|                                                           |                    |                   | Balance           |         | 21,049.09 |           |           |        | 31   | Int. to Oct. 6%                                                                               | 67   | 43.67    | 43.67 |
|                                                           |                    |                   | Balance           |         | 61,529.59 | 61,529.59 |           |        |      |                                                                                               |      |          |       |
|                                                           | 5 sh.              |                   | Atchafalpa Bond   |         | 21,049.09 |           |           |        |      |                                                                                               |      |          |       |
|                                                           | 40                 |                   | Pennae.           |         |           |           |           |        |      |                                                                                               |      |          |       |
|                                                           | 100                |                   | Reading           |         |           |           |           |        |      |                                                                                               |      |          |       |
|                                                           | 100                |                   | Balt. & Ohio      |         |           |           |           |        |      |                                                                                               |      |          |       |
|                                                           | 100                |                   | Penn. R.R.        |         |           |           |           |        |      |                                                                                               |      |          |       |

Figure 56. Customer's Statement

proper. As the included example shows, this statement is ruled into vertical columns for the entry of details regarding transactions, and is dated horizontally. Throughout, each transaction recorded is clearly designated as a purchase or sale, and its financial extensions as either debits or credits. At the bottom of the statement it is balanced to show the final money debit or credit balance, and the "long" or "short" securities in the account.

**Summary of Mr. Blank's Transactions.**—In the account of Mr. Blank here taken as an example, the customer in the beginning deposited as margin 5 Atchison general 4s, 40 shares of Pennsylvania, and his check for \$8,000. He at once proceeded to sell 100 Columbia Gas short at  $80\frac{1}{2}$ , and to buy 100 Reading at  $114\frac{1}{2}$ . A few days later he successfully "made a turn" in Southern Pacific by purchasing 100 shares at  $132\frac{1}{2}$  and two days afterward selling them again at 135. After this Mr. Blank did nothing for two weeks, when he "covered" his previous short sale by purchasing 100 Columbia Gas at  $81\frac{1}{4}$  at a loss of  $\frac{3}{4}$  of a point; at the same time he purchased 100 shares of Baltimore & Ohio R. R. at 125. After a few days more he purchased 100 shares of Pan-American Petroleum B stock at  $55\frac{5}{8}$  and sold short 100 shares of Crucible Steel at  $109\frac{1}{8}$ . This latter short sale was more successful than the former, since later on Blank "covered" at  $103\frac{1}{4}$ , although for three days he was forced to pay a premium of  $\frac{1}{4}$  for borrowing the short stock. Let us see how the bookkeepers of Jenkins & Co. posted the above and other items upon Blank's monthly statement.

At the outset Blank's securities deposited as margin on August 1 are entered as "Received" and he is credited with his check for \$8,000. His first two transactions—the short sale of Columbia Gas and the purchase of Reading, were also actually made on August 1. The date of these items on the statement, however, is August 2, for items are dated not according to the dates when contracts for the purchase and sale of securi-

ties are made on the Exchange floor, but when such contracts are settled by delivering or paying for the securities. If Blank's orders were executed on a Monday, for example, the contracts would ordinarily be settled Tuesday, etc., according to the regular daily settlement system employed on the New York Stock Exchange.<sup>20</sup>

**How the Brokerage Commission Is Entered.**—Brokerage commissions of Stock Exchange firms are governed by the scale of minimum rates contained in the Constitution;<sup>21</sup> these rise as the stock bought and sold is higher in price. The minimum rate for 100 shares of a stock selling at \$50 and above but under \$75 would be \$17.50; of one selling at \$75 and above but under \$100 would be \$20; of one selling at \$100 but under \$200 would be \$25; etc.

In connection with the purchase of 100 Reading on August 2, the reader will observe that Blank is debited for \$11,475. The commission of \$25 charged by Jenkins & Co. for making this purchase for him is added to the price of the stock (\$11,450) in the debit extension on the statement, instead of being posted as a separate item. On the other hand, the commissions on sales are subtracted from their cash extension, since such sales create a credit item on the statement. Thus, when Blank sells 100 Columbia Gas at 80½, he is credited with \$8,050 less a commission of \$20 and sales tax of \$4—or with \$8,026.

**The Item of Taxes on Sales.**—This matter of the sales tax, already alluded to in its economic aspects,<sup>22</sup> should also be noticed as it affects the customer's statement. When Blank sold his 100 Southern Pacific, a tax of \$4 was deducted from his resultant credit along with commissions; he was not taxed when he bought the stock, however, since the tax applies only to sales and not to purchases.

<sup>20</sup> See Chapter XII, p. 276.

<sup>21</sup> See Appendix XVd.

<sup>22</sup> See Chapter VIII, p. 207.

**Dividends and Premiums.**—In a previous chapter it was stated that dividends upon the customer's long stock were paid to him, while dividends upon his short stock he was himself forced to pay.<sup>23</sup> The accompanying statement gives illustrations of both cases. When the dividend on Reading is paid, Blank is already long 100 shares of this stock, and accordingly he is credited \$100 for the quarterly \$1 per share. But when the 50 cents per share quarterly dividend on Columbia Gas & Electric is declared, Blank is short of 100 shares, and consequently he is debited with \$50.

Still another item remains to be explained—the charge for a premium for three days of  $\frac{1}{4}$  on the 100 shares of Crucible Steel of which the customer is short. We have seen<sup>24</sup> that when the floating supply of a given stock becomes scanty and it is difficult to borrow it, the borrower must sometimes pay a premium to get the desired stock. Evidently this was Blank's experience with Crucible. On August 26 he sold 100 shares short at 110 and did not cover the sale until the 29th, when he purchased the same number of shares. In the interim, of course, Jenkins & Co. had to borrow the 100 Crucible for him and, owing to its temporary scarcity, had to pay a daily premium of  $\frac{1}{4}\%$ , or \$25, for it, for three days. Accordingly, Blank is debited for \$75.

**Computation of Interest.**—Lastly, there remains to be considered the important factor of interest charges. These are calculated upon the detachable slip on the right of the statement. The column headed "Balance for Interest" contains the cash amounts upon which the customer is due to receive or pay interest. To save time, all interest charges or credits are first calculated at 6%, and the total credits and debits are then adjusted to the correct and actual rate, which of course may be either more or less than the flat 6% rate first employed.

At the end of the month, a total interest item is obtained.

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<sup>23</sup> See Chapter VII, p. 188.

<sup>24</sup> *Ibid.*, p. 189.



As shown in the illustrating statement, Blank is thus debited with \$43.67. These figures, as has been stated, were arrived at on the basis of a 6% rate. But, let us suppose that our example is taken during a period of fairly tight credit, the money which the firm had to borrow for Blank probably cost fully 6%. The exact rate of interest at which he is charged is derived by averaging the rate paid by the house on all of its various loans during that month. Let us suppose that this average rate of interest amounts in this case to 6%. The firm adds  $1\frac{1}{2}$ —let us say—as a service or “carrying charge” to compensate it for its trouble, expense, and risk in making these loans for its customers. This means that in addition to the 6% at which the interest was already arbitrarily calculated, a carrying charge of  $1\frac{1}{2}\%$  must be made. Therefore, the \$43.67 (or interest at 6%) is increased by 25%, giving \$54.59 as the total interest and carrying charges. This sum is accordingly entered as a debit on the customer’s statement. The Constitution of the Exchange<sup>25</sup> forbids its member firms from competing unfairly with each other for business by charging “special and unusual rates of interest.” Such a practice is looked upon by the Exchange as tantamount to a breach of its commission law.<sup>26</sup>

After these interest items are figured in, Blank is shown to have a total debit balance at the end of the month of \$21,049.09. In addition, his account shows that he is long of the securities which he originally left with Jenkins & Co. as margin—namely, his five \$1,000 Atchison 4s and 40 shares of Pennsylvania, as well as 100 Reading, the 100 Baltimore & Ohio, and the 100 Pan-American Petroleum B shares, which he bought on margin during the month.

**Determining the Customer’s Margin.**—But what Mr. Blank is principally interested in, is what his equity in the account, or the sum of money belonging to him in it, amounts

<sup>25</sup> See Constitution (Rules, Chapter VII, Sec. 9).

<sup>26</sup> See Chapter XVI, p. 456.

to. This can be determined only by first imagining that his account has been completely closed—that is, that all his long stocks have been sold and all his short stocks bought in. Let us suppose that this is done on August 31, when Atchison general 4s are selling at 90, Pennsylvania at 70, Reading at 115, Baltimore & Ohio at 130, and Pan-American Petroleum at 58. At these prices we find that Blank's 390 shares of long stock (counting the five \$1,000 bonds as the equivalent of 50 shares) possess a market value of \$37,600.

In the interest of simplicity, the account here considered as an example contained no short stock at the end of the month. In case Mr. Blank had—let us say—carried over 100 shares of Steel short, a somewhat more complicated situation would have arisen, the complete consideration of which would lead us deep into the philosophy not only of bookkeeping practice but also of stock market behavior. It is of course true that such short stock should be represented by a credit money item, as far as the customer is concerned. On the other hand, the broker may be unwilling to reduce his customer's debit balance by the full market value of the short stock carried over, since he cannot always be sure that the stock could certainly be purchased at so satisfactory a price. Accordingly, different firms in their bookkeeping methods handle this situation in different ways; some firms go so far as to maintain two separate accounts for the customer—one for his long and the other for his short commitments, and require adequate margin upon each. Of course, much depends upon the character of the particular security or securities carried for a customer, long or short, as well as upon the trend of the stock market at the time. It may be—and often has been—argued that full credit for short stock should be offset against debits on long stock, on the theory that such a short commitment was really a sort of "hedge" and would provide more credit as declining prices created a greater debit on the long account. Unfortunately, however, the stock market does not always exhibit such uniformity of movement, and

frequently, while some stocks are rising others are declining. Thus it is quite possible for the customer's debit balance to be increased at the same time by rising prices on his short stock and declining prices on his long stock. If meanwhile his debit balance had been reduced by fully crediting against it the market value of the short stock, his unhappy broker might under the circumstances have to be prompt to call for more margin in order to save himself from serious loss.

**The Margin Card.**—A current record of Blank's equity in his account—or his "margin," as it is more often called—is constantly kept by the margin clerk of the brokerage house. The broader economic significance of margins has already been discussed in a previous chapter.<sup>27</sup> The margin clerk keeps a separate record for every customer of his house, and constantly adjusts the customers' margins as the trend of security prices dictates. In this way the commission house is always in touch with the amount of margin maintained by each of its customers, and in a position to call the given customer for more margin, or to know whether he can safely make new transactions on the basis of his existing margin. The margin cards used by different Stock Exchange commission houses differ more or less in their details. Figure 57 represents a form of margin card easy for the layman to understand; it cannot be said, however, that this particular form is typical of margin cards generally employed. The items which it contains show the condition of Mr. Blank's margin at the time when his monthly statement above included was issued. It will be noted that the securities which the customer originally owned outright, but which he deposited as margin, are entered exactly like the securities which he subsequently bought on margin. At the top of the margin card, the customer's debit or credit balance, and the market value of his long and short stock are entered. These figures, as well as the margin derived from

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<sup>27</sup> See Chapter VII, p. 184.

| JENKINS & CO.                               |                         |                         |     |        |        |
|---------------------------------------------|-------------------------|-------------------------|-----|--------|--------|
| NAME <i>John Blank</i>                      |                         | TELEPHONE <i>1234</i>   |     |        |        |
| ADDRESS <i>13 Forest St., New York City</i> |                         |                         |     |        |        |
| OCCUPATION <i>Manufacturer</i>              |                         |                         |     |        |        |
| BALANCE                                     | VALUE OF<br>SECURITIES  | MARGIN                  | %   | POINTS |        |
| DR.                                         | LONG                    |                         |     |        |        |
| \$21,049. <sup>09</sup>                     | \$37,600. <sup>00</sup> | \$16,550. <sup>91</sup> | 44  | 42     |        |
| CR.                                         | SHORT                   |                         |     |        |        |
| \$                                          | \$                      | \$                      |     |        |        |
| LONG                                        | SHORT                   | SECURITIES              | @   | AMOUNT |        |
| 5m                                          |                         | <i>Atchison Gen. 4s</i> | 90  | 4      | 500.00 |
| 40                                          |                         | <i>Penna.</i>           | 70  | 2      | 800.00 |
| 100                                         |                         | <i>Reading</i>          | 115 | 11     | 500.00 |
| 100                                         |                         | <i>Balt. &amp; Ohio</i> | 130 | 13     | 000.00 |
| 100                                         |                         | <i>Pan Pete. B</i>      | 58  | 5      | 800.00 |
| <hr/>                                       |                         |                         |     |        |        |
| 390                                         |                         |                         |     | 37     | 600.00 |

Figure 57. Customer's Margin Card  
Showing Mr. Blank's margin, debit balance, securities, etc.

them by methods already outlined, are erased and changed as the fluctuations in market prices or other factors necessitate.

**Margin in Points and Percentage.**—Margin is often computed in points—that is, in the number of dollars per share which stock prices would have to decline before the margin became exhausted. Since Blank's margin on his 390 long shares is \$16,550.91, it amounts in even figures to \$42 or 42 points on every single share of the long stock. In other words, every one of the 390 long shares would have to decline on the average 42 points (or \$42 per share) before Blank's margin would be exhausted.

Margin may also be figured in percentages. Thus in Figure 57 Blank's margin is stated to be 44%, because his equity of \$16,550.91 bears that proportion to the total value of his long stock, \$37,600. In very high- or very low-priced stocks, the percentage of the customer's margin is especially important. If, for example, a customer happened to hold shares whose price stood at about \$600 or \$700 apiece, a 50-point margin would be insufficient and a 20-point margin might be perilous. On the other hand, if the customers' shares were low-priced stocks, selling—let us say—at \$5 apiece, even a 10-point margin would be impossible, and a 3-point margin perhaps conservative. In such cases the percentage relation of the amount of the margin to the value of the shares would have to be reckoned. A customer might have a 50-point margin on a \$500 stock, and have only a 10% margin, and yet his margin on \$5 stock would be 40% if it were 2 points. Thus it can be seen that the number of points of margin demanded by the broker varies with each individual case, and cannot be set at any one limited figure, either by law or by regulations of the Stock Exchange itself. It would be equally impractical to attempt to establish a fixed percentage between the margin and the value of the securities of which the customer is long or short. It is sig-



nificant, however, that the Constitution of the Exchange contains the following provision:<sup>28</sup>

The acceptance and carrying of an account for a customer, whether a member or a non-member, without proper and adequate margin, may constitute an act detrimental to the interest and welfare of the Exchange.

**Safeguarding the Broker's "Box."**—From the foregoing description of a single customer's experience with his brokerage house, as well as from what has already been said concerning the general machinery of the Stock Exchange in earlier chapters, a fair idea can be obtained of the daily routine of a typical Wall Street commission house. One picturesque feature of this routine, however, remains to be mentioned. Many Exchange houses, because of their unwillingness to leave security certificates of considerable value "in the box" in their offices overnight, rent safe deposit vaults from the New York Stock Exchange Safe Deposit Company in the basement of the Stock Exchange building,<sup>29</sup> or from other safety deposit companies. Before the opening of the market each morning, employees of Exchange houses may be seen, followed by their guards, removing from the Broad Street entrance to the Safe Deposit Company's vaults the heavy steel boxes of their firms containing the securities belonging to them, their partners, and their customers. And later on, after the Exchange has closed and business for the day is over, they return with their closely guarded burdens, and redeposit them in the vaults for the night.

The Stock Exchange was originally created to provide a free and open organized securities market where the American public could purchase and sell the leading American stocks and bonds. For over a century it has rendered indispensable economic services to the whole nation. Without the facilities provided by the Exchange houses for executing the orders of the public, the present broad and continuous securities market on

<sup>28</sup> See Constitution (Rules, Chapter XII).

<sup>29</sup> See Chapter III, p. 76.

its floor would, of course, be impossible to maintain. These orders from the public at large can enter the securities market on the Stock Exchange only through the commission house. For this reason the commission broker is the principal if not the only representative of the Stock Exchange with whom the average man comes into personal contact. Usually, too, he is a partner or employee of a member of the Exchange, rather than a member himself.

**Present and Former Scope of the Stock Market.**—In the earlier years of its history, it was inevitable that the facilities of the Stock Exchange should have been employed locally rather than nationally. Even apart from the invention of the telegraph, the economic growth of the United States did not until the past few decades really demand its services in extending the scope and availability of the organized security market in New York. For, while our Great West was still hewing down the primeval forest, laying road beds, and establishing those villages which were destined in after years to experience so remarkable a growth, its inhabitants, still pioneers, were naturally possessed of no surplus to invest in stocks and bonds.

But with the steady westward thrust of population and wealth into our southern and western states, the demand for stock market facilities has led to a similar extension of the Stock Exchange system into practically all parts of the nation, through the rise of the "wire house" type of Stock Exchange commission firm. The first sign of this coming development was shown in 1873, when a prominent Wall Street firm established a private telegraph line to its uptown office at 23rd Street—a great convenience at a time before the elevated railroad or telephone system, when it took over an hour to communicate between the two offices. The obvious advantages of such speedy means of communication soon bore more extensive results. In 1879 private wires were obtained by various Wall Street firms to their offices in the neighboring centers of Boston and Philadelphia. A similar connection with Chicago was

inaugurated in 1881, and with San Francisco in 1901. Since that date the wire systems of several large Stock Exchange commission houses have crossed the border to various Canadian cities. One Wall Street firm has even installed a private wire by cable to Havana, Cuba. Stock Exchange firms also have established branch offices or affiliated companies in the leading centers of Europe. And when the steady growth of the Stock Exchange as an international market and credit center is realized, it seems patent that the future may witness the extra-national extension of the wire systems of many Stock Exchange houses.

At first considerable prejudice was shown against the new "wire house." It was thought that no firm could properly control its business over such distances. There was even a tendency to discriminate against the loans made by such houses, because of the supposed unreliability of the business. If anything, just the opposite attitude is taken today, for, other factors apart, the wire house represents a diversification of business risk over many parts of the country.

**The Wire Systems of Today.**—Speaking of the extensive modern use of private wire systems by financial and commercial firms, a leading New York financial publication<sup>80</sup> has stated:

Now there are about a thousand private wires in operation, tapping every city or locality of any importance in the United States and Canada. It is estimated that they are more than 500,000 miles in length, and represent a yearly expenditure of more than \$15,000,000, to which must of course be added the wages of the operators who man them and the other expenses for which their lessees are liable. It is therefore probable that the private wire system of America costs more than twenty million dollars a year, and perhaps the total is a great deal higher . . .

Between New York and Chicago it is estimated that there are 100 leased wires; eight between Chicago and the Pacific coast; 100 between New York and Boston; 75 between New York and Philadelphia, Baltimore and Washington; 10 between New York and points south

<sup>80</sup> "The Nerves of Wall Street," in *Commerce and Finance*, June 22, 1921, p. 879.

of Washington; 15 between New York and Montreal; 25 between, New York, Pittsburgh and Buffalo; and about 25 from New York to other nearby cities . . .

The private wires now in operation are mainly employed by those who are engaged in business on the great speculative exchanges of the country, the New York Stock Exchange, the Chicago Board of Trade, the New York Cotton Exchange, and the smaller stock and commodity exchanges of the country, of which there are about fifty . . .

Then there are many large industrial and financial concerns that operate private wires in handling their business. The Federal Reserve Banks have a private wire system connecting them and their branches with each other and the Federal Reserve Board in Washington. The United States Steel Corporation and most of the big packers have their own private wire systems. Many of the large banks and banking firms lease private telephone circuits between New York and their home offices.

Incidentally, not merely the figures relating to the extensiveness of these wire systems should be noted, but also those respecting their large annual cost. When those who may consider that the Stock Exchange brokerage firm's commissions are easily earned, or that the business is a royal road to fortune, realize that the house engaged in it must, in addition to earning interest upon a valuable Exchange seat and upon its business capital, bear this heavy overhead cost of its leased wires, a more just and accurate idea of what the average commission house does for its customers can be obtained.

**The Modern Wire Room.**—In the investment transaction traced in an earlier chapter,<sup>31</sup> Jenkins & Co. was a typical wire house, with a branch office in Baltimore and its main office at 500 Wall Street and a private wire connecting the two. In addition, the firm probably had other private wires, reaching out from the New York headquarters to branch offices and correspondent houses at other points. In the Wall Street office of the firm, if these private wire connections were numerous, the order department might well occupy a whole room by itself,

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<sup>31</sup> See Chapter VI.

with expert telegraphers in charge of the far-flung wires. This work calls for vastly more accuracy and speed than ordinary telegraphy, and such operators must be unusually skilled in it to meet satisfactorily the frequent pressure and unusual demands put upon them. Practically all such wire rooms have a device known as a "tell-tale," which records all messages passing through it. Its records are filed, and thus the responsibility for the rare errors which occur can quickly be determined.

The speed with which such a wire system (including operations on the Stock Exchange floor) works, is truly surprising, when its complexity and the distances it covers are remembered. The same authority<sup>32</sup> quoted above cited the following instance:

A large New York and Chicago firm has an interesting speed record that has not yet been duplicated. Their correspondents in San Francisco sent in an order to buy a security on the New York Stock Exchange. The order was executed and advice of its execution received in San Francisco 56 seconds after it was given.

According to the same writer, one of the large Exchange commission houses has in the "regular order of business" received orders over their Havana cable, executed them, and had the report of the execution back in Havana in less than a minute.

**Arrangement of a Wire System.**—The wire house arranges its wires much as the railroad its lines of track, so as to pick up along their length sufficient traffic to justify their expense. Hence the house places correspondents along its wire routes. No contract is entered into regarding the length of time the connection will be maintained. The wire house notifies its correspondents in the beginning of its requirements with regard to such matters of business between them as margin requirements, etc. It is, of course, usually much easier for the wire house in Wall Street to call its correspondents for more margin than its customers in or out of New York City.

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<sup>32</sup> "The Nerves of Wall Street," in *Commerce and Finance*, June 22, 1921, p. 880.



Taken as a whole, the Stock Exchange system, with its various units of the board room, the Wall Street commission houses, their branch offices and correspondents, and the thousands of miles of private leased wires which connect them, has practically annihilated the considerations of space and time in the operation of America's principal securities market. A San Francisco customer has access to the board room market practically as ready and immediate as a customer in William, Nassau, or Broad Street offices—a stone's throw from the Stock Exchange building. By the magic of applied science and the trained skill of the operators, Los Angeles is rendered as close to the Exchange floor as Boston, or New Orleans as Philadelphia. Of course, the private brokerage wires are used to transmit news as well as orders to buy or sell, and in consequence the system makes for uniform intelligence and knowledge all over the land regarding security values, as well as an equalized instance of dealing in the market.

**National Character of the Stock Market Today.**—One practical result of this accessibility of the Stock Exchange to all parts of the United States and to nearby countries has been that its securities market is vastly less subject than formerly to local influence. Before the era of the fully developed wire house, the Stock Exchange was to a considerable extent a New York institution. There were bull leaders and bear leaders in Wall Street, and the stock market was to some extent subject to their personal attitude and operations. But, although the memory of these earlier generations of Wall Street men has given rise to a swarm of modern legends and modern superstitions regarding the Exchange, the stock market is today a national, not a local market, and has long since grown too big for the operations of yesteryear. An investigation of the Exchange market with respect to the origin of the orders coming into it,<sup>33</sup> undertaken in 1909 by the Hughes Commission, showed that on a selected day "52% of the total transactions on

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<sup>33</sup> See Appendix XVe.

the Exchange apparently originated in New York City, and 48% in other localities." Since that date, the out-of-town business transacted upon the Exchange has experienced a huge proportional increase, estimated at times by some authorities at 80% orders from outside of New York City to 20% New York City orders.

While no statistics comparable in exactness to those of the Hughes Commission exist for recent years, nevertheless a great increase in the proportionate amount of out-of-town orders on the Exchange, apart from being a matter of common knowledge in Wall Street, is shown by the increase in the number of correspondents since 1909, as well as by the greater number of shareholders in the large corporations whose stocks are listed on the Exchange.

**Benefits of the Extension of Brokers' Wires.**—Certain valuable economic results have flowed from this evolution in the market. A broader market has been created by it, representing more buyers and sellers than formerly, and hence with more power to render its listed securities negotiable and to distribute them among investors.

Moreover, the swift extension of branch offices and correspondents has made it possible for American business men to travel extensively, either in the United States or abroad, and at the same time keep in perfect touch with the market. The necessity for such accommodation has created what is known as "give up business." If, for example, a customer of a commission house with offices only in New York should be called away to some other city and while there should wish to have an order executed on the Stock Exchange for his account, he can go into any branch office or correspondent of any Stock Exchange commission firm there and place his order, "giving up" the name of the firm with whom he has his account. The branch office or correspondent, after verifying the facts over its wire system, will at once permit his order to be executed. Thus, any customer of any Stock Exchange firm is always as

near the stock market as the nearest branch office or correspondent of any Stock Exchange house. Recently, the radio has even enabled branch offices of Stock Exchange firms to be established on some of the larger ocean liners for the convenience of their passengers. In consequence, the New York securities market is readily accessible to practically all American business men at all times.

**Overcoming Time and Space.**—Until the last century, it had been one of the perennial problems of government to control large areas of land. Lack of facilities for communication and transportation had in the end frustrated even the ambitions of the Cæsars and Napoleons of history. That this difficulty was realized by the founders of this nation is attested by a writer<sup>84</sup> upon the modern wire house:

George Washington advised against including the Mississippi River in the Union. Webster opposed taking in Texas and Oregon. Monroe once warned Congress that a country which reached from the Atlantic to the Middle West was "too extensive to be governed except by a despotic monarchy." But they spoke in the days when mountains still retained mastery over man, when distances were measured in miles rather than in minutes.

Due to the efforts of scientific inventors and business organizers (and, incidentally, by the investors and speculators in the stock market who financed them), this former supposed limitation upon the physical size attainable by free governments has been dissipated. An almost equally notable triumph has occurred in the economic realm of business through the growth of free markets, and by the same means. The telegraph has made possible the rise of world markets, accompanied by greater stability in industry and trade. Without facilities for instant communication, the present international market places would crumble and again resolve themselves into local markets, with scanty and precarious trading, and a parochial

<sup>84</sup> T. S. Brickhouse, "The Back-Stage Side of the Wire Business," *Commerce and Finance*, June 22, 1921, p. 884.

outlook.<sup>85</sup> In the instance of the Stock Exchange, therefore, the development of its national and even international free market for securities, while fundamentally due to increased national wealth and natural economic forces, has in a practical and immediate way been due to the extension of the commission brokerage house through its wire system to branch offices and correspondents all over the nation, and even beyond its borders.

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<sup>85</sup> See Chapter II, p. 59.

## CHAPTER XVI

### THE ADMINISTRATION OF THE STOCK EXCHANGE

**"What Is the Stock Exchange?"**—Before considering in detail the administration of the Stock Exchange, it is necessary to answer a common question, concerning which considerable confusion exists—"Exactly what is the Stock Exchange?" The term "Stock Exchange" is commonly and correctly employed to denote: (1) the building at Wall and Broad Streets where trading in securities takes place; (2) the association of brokers and dealers which owns this building and conducts trading operations inside it. But in addition, the term "Stock Exchange" is also often used in a loose and utterly inaccurate way with reference to almost everything and everybody in the Wall Street financial district, including not merely many types of banking establishments and corporation offices, and indeed the whole machinery of the money market located there, but also fly-by-night promoters of worthless securities who may hire an office for a few weeks between City Hall and the Battery. Sometimes these gentry are suddenly impelled to seek a healthier climate over the Canadian or Mexican border, while the permanent and legitimate financial houses and institutions in the Street remain to inherit the odium of their swindles and misdeeds. At most, the Stock Exchange is only a part of what is known as "Wall Street." It must not be confused with the large number of enterprises, companies, and individuals, both legitimate and illegitimate, which are located in its immediate neighborhood.

The exact purpose of the Stock Exchange (using the term



in its meaning of an organization) can best be stated by quoting Article I of its Constitution:

The title of this Association shall be the "NEW YORK STOCK EXCHANGE."

Its objects shall be to furnish exchange rooms and other facilities for the convenient transaction of their business by its members; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade and business.

This simple and straightforward statement of fact defines with exactness the limits within which the Stock Exchange operates.

**Stock Exchange Membership.**—From 1879 to 1929, the New York Stock Exchange as a voluntary association limited its total membership to 1,100; in 1929 this was increased by 25% to 1,375 members.<sup>1</sup> Except in the recent interval when the increase of 275 new "seats" was being taken up, the Stock Exchange membership has always been maintained at its permitted maximum. Of the existing membership, some 200 members live and carry on their chief if not their entire business outside of New York City. Also, some Exchange members are partners and representatives of various types of financial houses, some are in business on the floor for and by themselves, and some are private capitalists who use their membership mainly to secure the lower rate of commissions permitted on orders given by one Exchange member to another. Corporations are not allowed to possess a Stock Exchange membership.<sup>2</sup>

A non-member secures a "seat" (as it is still called) by purchasing from a retiring or recently deceased member, unless there should be authorized but unsold memberships available. The price of the seat varies with supply and demand, and the proceeds of its sale go to the member who is relinquishing it.<sup>3</sup>

<sup>1</sup> See Appendix IIIc.

<sup>2</sup> See Appendix XVIa.

<sup>3</sup> See Appendix XVIb.

Membership in the Exchange, however, is not simply a matter of money. Even though the applicant for membership has successfully arranged to purchase his seat, it will not be transferred to him without the favorable vote of the Committee on Admissions. This Committee thoroughly reviews his past business career, and if it has been such as to indicate a lack of integrity on his part, he will not be allowed to acquire the seat. The applicant must also be free from debt, and have adequate capital to enter the business; if he is purchasing his membership with borrowed funds, no lien arising from them can rest on the seat so that its full value will not be applicable to his debts in the event of subsequent insolvency. Certain formal requirements must also be met—the applicant must, for example, be an American citizen, be sponsored by two Exchange members, etc. Thus the efforts of the Stock Exchange to safeguard both its own members and their customers, the investing public, in all security transactions conducted under its auspices, commence at the very outset of each member's career.

**Constitution and Rules.**—The new member is also required to sign the Constitution and Rules of the Exchange, thereby promising to abide by its regulations and making himself subject to the rigorous discipline for which it provides. The necessity for and justice of these Stock Exchange rules are indicated by the fact that for their own sake Exchange members heartily advocate their strict and instant enforcement, even on occasion against themselves.

The Constitution of the Stock Exchange has evolved gradually from the original brokers' agreement made under the buttonwood tree in 1792;<sup>4</sup> it embodies over a century's experience on the part of several generations of American stock-brokers, through the many trying and difficult periods of our past national economic life. It makes no pretense of providing specifically for all possible eventualities in a highly complex and ever-changing business. It lacks the ponderous inclusiveness,

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<sup>4</sup> See Chapter III, p. 63.

meticulous detail and constant stress upon definition of many of our present-day statute books. Instead, it deals with principles rather than instances, and provides for the determination of future undefined problems justly, swiftly, and openmindedly. It is superbly practical, and leaves the way open for the enforcement of its provisions according to the substance and spirit as well as the mere letter of the law. It has made precedents as occasioning circumstances have arisen. From time to time the Constitution and Rules are revised and recodified; the last such revision became effective June 25, 1925.

**The Governing Committee.**—Subject to the Constitution, the legislative and judicial powers of the Stock Exchange over its members are placed without qualification in the hands of the Governing Committee.<sup>5</sup> This body consists of 40 members of the Exchange, together with its President and Treasurer. Each year ten governors are elected by vote of the entire membership, to serve four years. This method makes for conservatism in the policy of the Exchange, yet apart from this fact the same men are often reelected as governors term after term.

The officers of the Exchange consist of the President, Vice-President, Treasurer and other members of the Governing Committee, and the Assistant to the President, the Secretary, the First Assistant Secretary, the Accountant and the Economist.<sup>6</sup> The executive authority of the Exchange is vested in its President, who directs the enforcement of its regulations and presides over the Exchange and its Governing Committee. In the absence of the President, his duties are discharged by the Vice-President. The Treasurer receives, has charge of, and disburses the funds of the Exchange under instructions from the Finance Committee. The Secretary performs a wide variety of duties which are largely specified in the Constitution, in which tasks he is assisted by the First Assistant Secre-

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<sup>5</sup> Constitution, Articles II and III.

<sup>6</sup> *Ibid.*, Articles II-VII.

tary. The Accountant and the Economist perform such work as the Governing Committee may prescribe, the duties of the former pertaining primarily to the accounts of the Exchange and of its members, and of the latter to statistical and research work in connection with advising the Exchange in matters of economic policy. The President and Treasurer are elected annually by the entire Exchange membership; the Vice-President is chosen annually by the Governing Committee from its own members; the Assistant to the President, Secretary, First Assistant Secretary, Accountant and Economist are appointed by the Governing Committee.

The governors of the Stock Exchange are heirs to a long and honorable tradition, and to be elected a governor is considered a high honor. The ability and conscientiousness which they lend to their responsible tasks are proverbial in Wall Street and out of it. Sheerly out of a sense of duty and loyalty to the Exchange and the public whom the Exchange serves, these forty carefully selected and experienced members, whose time and ability possess a constant cash value and are constantly demanded by their own interests and by other business enterprises, willingly give no small amount of service gratis to the Stock Exchange each year.

**Powers of the Governors.**—In the hands of its Governing Committee is invested the real power of the Stock Exchange organization. Its power to discipline members of the Exchange is practically absolute, owing to two fundamental provisions of the Constitution. The first of these<sup>7</sup> (*italics are the author's*) reads as follows:

A member who shall have been adjudged by a majority vote of all the existing members of the Governing Committee guilty of a violation of the Constitution of the Exchange, or guilty of the violation of a rule adopted pursuant to the Constitution, or guilty of the violation of a resolution of the Governing Committee regulating the conduct or business of members, *or guilty of conduct or proceeding inconsistent with just and equitable principles of trade*, may be sus-

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<sup>7</sup> Constitution, Article XVII, Sec. 7.

pended or expelled as the said Committee may determine, unless the offense is the violation of a resolution or rule for which a different penalty has been provided, in which case such other penalty may be imposed.

The latitude and degree of the governors' authority are further extended by another section of the same article<sup>8</sup> reading:

The Governing Committee may, by a vote of a majority of all its existing members, suspend from the Exchange for a period not exceeding five years, a member who may be adjudged guilty of any act which may be determined by said Committee to be *detrimental to the interest or welfare of the Exchange*.

Thus the power exercised by the governors is conferred in the most comprehensive terms. As the above and other sections of the Constitution indicate, they sit in absolute authority over every member and his partners. Penalties are often inflicted for acts that violate no formal law and that would not give a plaintiff any technical standing in a court of law. In their nature, therefore, Stock Exchange regulations are searching and ethical rather than merely legal rules. The high standard of conduct enforced by such thoroughgoing regulations as these is necessary for the absolute mutual confidence enjoyed by members in each other, in the exercise of their trading privileges.

**Disciplinary Methods.**—The methods employed by the Governing Committee in disciplining members are swift but equitable. Having been presented with the charges made against him in writing, the accused member appears before the Governing Committee, sitting as the jury in his case—a jury which is expert in the complexities of Exchange transactions and which gets at the true facts of the case directly and keenly. They decide whether the accused member's conduct has or has not violated the rules and principles of the Exchange. From their decision the member on trial

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<sup>8</sup> Constitution, Article XVII, Sec. 8.



can, of course, appeal to the courts.<sup>9</sup> One such case—it might be noted in passing—caused six years of litigation in the courts. The remarkable and significant fact that in every one of the many instances where this has occurred the courts have sustained the action of the board of governors, speaks well for the justice and ability with which the latter conducts the affairs of the Exchange.<sup>10</sup> The decisions of the governors are quickly effected and are governed by the merits of each individual case. Because of their complete authority in disciplinary matters, the morale and spirit of the Stock Exchange are in the keeping of its Governing Committee.

**Other Stock Exchange Committees.**—The work of the Stock Exchange, however, is too extensive and too intricate to be conducted by a single committee of 42 members (Figure 58). Accordingly, standing and special committees composed of members of the Governing Committee and appointed by it<sup>11</sup> are delegated to supervise and conduct special parts of the work. Appeals from the decisions of most of these committees can be taken to the Governing Committee, as the final governing authority of the Exchange.<sup>12</sup>

A brief survey of these standing committees is therefore needed for an adequate understanding of the administrative side of the Stock Exchange.

The Committee on Admissions (15 members) passes on applications for membership in the Exchange, as above described, as well as upon applications for reinstatement of members suspended on account of insolvency. It also investigates the causes for the insolvencies of members.

The Arbitration Committee (9 members) investigates and decides claims or matters of difference involving contracts subject to the rules of the Exchange between members, or at the instance of a non-member, between a member and a non-member.

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<sup>9</sup> See Appendix XVIc.

<sup>10</sup> See Appendix XVId.

<sup>11</sup> See Constitution, Article X.

<sup>12</sup> *Ibid.*, Article XI.

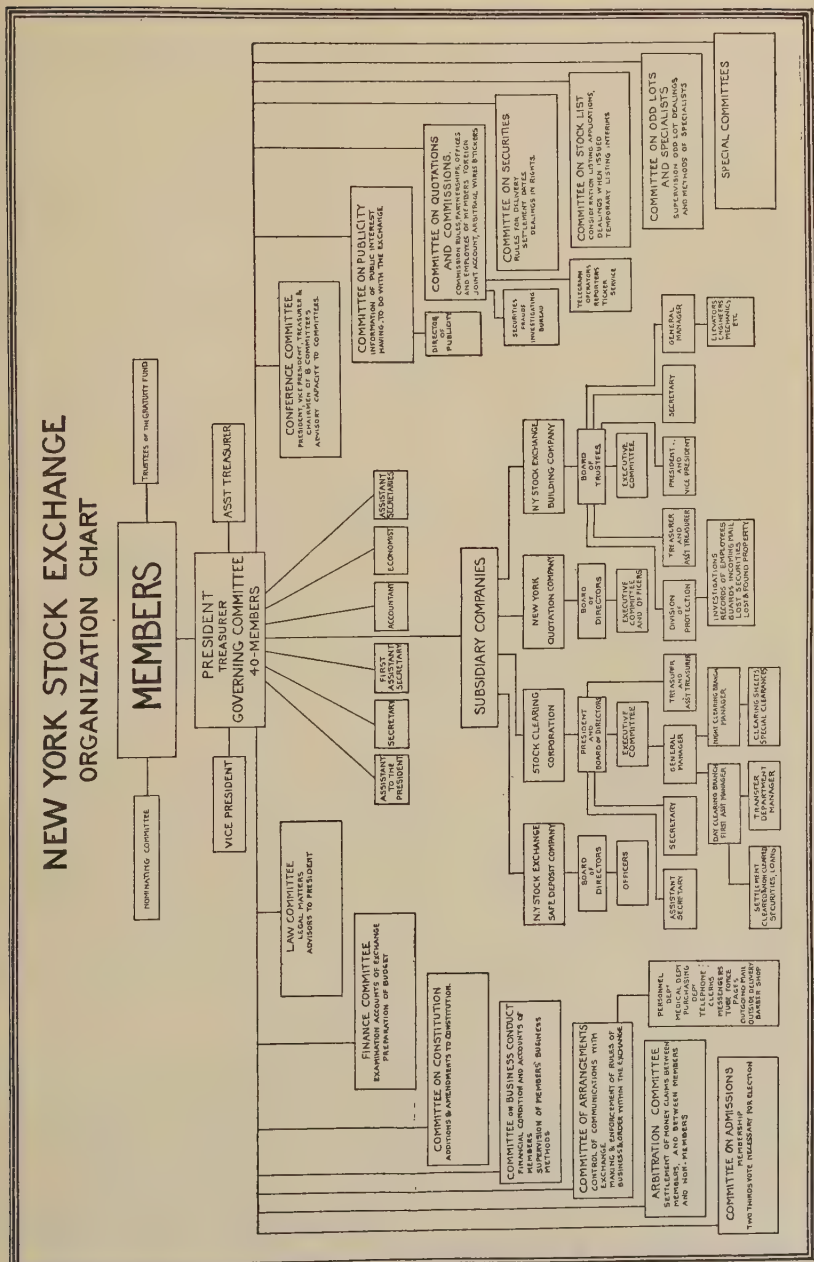


Figure 58. Organization Chart of the New York Stock Exchange, as of 1925

The Committee of Arrangements (9 members) maintains the Stock Exchange building and controls the telephone and telegraph lines running into it. It supervises the observance of many provisions of the Exchange Constitution and Rules, and the conduct of business on the floor, considers complaints of violation of rules, purchases supplies, and engages, pays, and discharges employees.

The Committee on Business Conduct (6 members) considers the business conduct and financial condition of members and their customers' accounts. It observes the course of transactions on the Exchange with the view to seeing whether resort is being had to improper transactions. It can at any time examine into the dealings of any member, and report to the Governing Committee any matter which in its judgment requires the consideration of that Committee.

To the Committee on Constitution (5 members) are referred all proposed additions, alterations, or amendments to the Constitution of the Exchange.

The Finance Committee (7 members) examines, audits, and budgets the accounts of the Exchange, and reports to the Governing Committee thereto.

The Law Committee (5 members) deals with matters of law affecting the interests of the Exchange, advises the President when requested by him, and in association with the President represents the Exchange in all matters affecting its general interests. It is authorized and empowered in its discretion to examine into the dealings of any member of the Exchange.

The Committee on Odd-Lots and Specialists (5 members) has general supervision over dealings in lots of stock of less than 100 shares and the methods of specialists.

The Committee on Publicity (5 members) has the duty, under the direction of the President, of keeping the public correctly informed concerning matters of public interest having to do with the Exchange.

The Committee on Quotations and Commissions (9 members) requires observance of Exchange regulations regarding

commissions, partnerships, member offices and foreign joint-account arbitrage. It also has charge of all matters relating to the collection, dissemination, and use of quotations, and can approve or disapprove telephone, telegraph, or wireless connections of member firms.

The Committee on Securities (5 members), subject to the Constitution and Rules of the Exchange, can make rules relating to the delivery of securities on Exchange contracts,<sup>13</sup> including reclamations therefor, irregularities therein, and interest and dividends thereon; and also to due bills, contracts for future delivery and deposits on Exchange contracts. It also may permit dealings on the Exchange in rights growing out of listed securities, and make regulations therefor.

The Committee on Stock List (6 members) makes rules prescribing requirements for listing securities, and receives and considers all applications for placing securities on the list of the Exchange. Depending upon the nature of the securities in each case, and in accordance with detailed provisions of the Constitution, the Committee in some cases can list and merely report afterwards, and in still other cases only recommends to the Governing Committee that issues be listed and leaves decision in the matter to the Governing Committee. The Committee on Stock List can, however, remove from the list any security at its maturity, or when its outstanding amounts have been so reduced as to render it advisable.<sup>14</sup>

The Conference Committee (11 members) is composed of the President, Vice-President, Treasurer, and the Chairmen of the Committees on Admissions, Arrangements, Business Conduct, Law, Odd-Lots and Specialists, Publicity, Quotations and Commissions, and Stock List. This Committee hears reports from the various committees and others, advises with them concerning questions affecting the welfare of the Exchange, and recommends to the Governing Committee such action as in its opinion will prove beneficial to the Exchange.

<sup>13</sup> See Appendix XVIe.

<sup>14</sup> See Chapter IV, p. 105.

In addition to these standing committees, the Governing Committee also appoints from its membership special committees, for special purposes outside the particular province of any standing committee.

**Subsidiary Corporations.**—To further its work, the New York Stock Exchange has also several times organized subsidiary corporations, all of whose stock is held by the Governing Committee as trustees for the whole membership of the Exchange.

The Stock Clearing Corporation, as we have seen,<sup>15</sup> supervises the clearance and settlement of Exchange contracts and otherwise facilitates the transaction of Exchange business. The New York Quotation Company facilitates the collection and dissemination of Exchange quotations. The New York Stock Exchange Building Company holds title to the Exchange's building and fixtures, and makes repairs, improvements, and extensions thereto. The New York Stock Exchange Safe Deposit Company maintains security deposit vaults for the convenience of Exchange members.

**Special Departments.**—Many special departments exist in the Stock Exchange organization, all under the general but complete authority of the Governing Committee, but each under the immediate supervision of some particular committee, officer, employee, or subsidiary corporation. The Statistical Department in the office of the Economist, which was inaugurated in 1924, is an example. In the Stock Exchange building are also located certain conveniences to its members, officers or employees, such as its medical department, barber shop, etc., and also the quarters of the Stock Exchange Luncheon Club.

**Employees of the Stock Exchange.**—This general account of the human mechanism of the Stock Exchange administration must include mention of its many and various employees. These range from experts of long experience who, under the

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<sup>15</sup> See Chapter XII.



supervision and authority of the Governing Committee or its subcommittees, are in immediate charge of responsible and highly technical operations, down to the army of cleaners and scrubwomen who invade the building after the close of each day's market, to put the Exchange in condition for the next day's business. In number, the floor employees of the Exchange aggregate several hundred persons, and include tube attendants, pages, bond clerks, phone attendants, price-reporters, and telegraph operators.<sup>16</sup> In the Night and Day Branches of the Stock Clearing Corporation a large group of highly trained and efficient clerks and executives carry on the vital work of clearance. Over all a corps of watchmen stand guard day and night.

**Association of Stock Exchange Firms.**—To correct prevalent misunderstanding and confusion, a word should also be added here concerning the Association of Stock Exchange Firms, which is composed of the partners of Stock Exchange members. While this Association has no official connection with the Stock Exchange, nevertheless it cooperates with the Exchange in many ways to improve conditions and correct defects in the New York securities market. The purpose of this Association is "to promote more friendly relations among its members, and urge the maintenance of high standards and just principles of business." The cashiers' section of this Association is composed of the cashiers of the various Exchange houses, and serves as a clearing house for the discussion and investigation of the many technical practical problems constantly arising in the stock brokerage business.

**Disputes Regarding Contracts.**—With this brief but fairly comprehensive sketch of the organization and methods of Stock Exchange administration, we can pass on to a few of the typical problems which call for solution and settlement by its authorities. And first, something should be said regarding

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<sup>16</sup> See Chapter III, p. 79.

such disputes as arise from transactions made on the floor of the Exchange. In previous chapters the conditions under which contracts are entered into on the Stock Exchange have been briefly described. Often, indeed, a single word or even a mere nod of the head constitutes an agreement to buy or sell securities worth many thousands of dollars. Occasionally, however, in the speed and rush of the trading, misunderstandings will arise. Some of these are settled on the spot by the parties concerned.<sup>17</sup> The rule of the Exchange is that, once entered into, a bargain must stand, unless *both* parties to it agree to alter its terms. Accordingly, any serious disputes are taken before the Arbitration Committee and judged entirely on their merits, justice being done quickly and effectively. On appeal from this committee, the case may be taken before the Governing Committee as the final authority in the Exchange.

**"Wash Sales."**—So much is said concerning "wash sales" that a word concerning them is necessary here. A "wash sale" occurs when two parties engage in fictitious transactions in order to establish artificial prices, with no real intention of exchanging money or goods. This indefensible practice is non-existent on the floor of the New York Stock Exchange. We have seen<sup>18</sup> that the original Constitution of the Exchange provided expulsion for any member of the Board "making a fictitious sale or contract." The present Constitution<sup>19</sup> states:

A member who shall be adjudged by a majority of all the existing members of the Governing Committee guilty of making a fictitious transaction or of giving an order for the purchase or sale of securities the execution of which would involve no change of ownership, or of executing such an order with knowledge of its character, shall be suspended or expelled as said Committee shall determine.

Both by the old custom of the Stock Exchange and by the laws of New York State (since 1913), a stockbroker is compelled to render his customers on their request a confirmation<sup>20</sup>

<sup>17</sup> See Chapter VI, p. 165.

<sup>18</sup> See Chapter III, p. 64.

<sup>19</sup> Constitution, Article XVII, Sec. 3.

<sup>20</sup> See Chapter XV, p. 419.

of every order executed for them, which states the name of the firm from whom the customer's stocks were purchased, or to whom they were sold. This important safeguard obviously prevents the broker from only pretending to execute the customer's orders, since it enables the customer to verify their execution readily and quickly.

**Matching Orders.**—A similar but subtler evil consists of "matching orders." An outside party might conceivably hire two brokers, and by giving orders to one to buy and to the other to sell, at identical prices, manipulate the price of a security listed on the Exchange. Both brokers could be quite innocent of any intention of misdoing, and still be the unconscious agents of collusion. For such a practice is contrary to the rule of the Stock Exchange quoted above, which forbids the execution of "an order for the purchase or sale of securities the execution of which would *involve no change of ownership.*" In practice, however, two Exchange brokers, even if so inclined, could scarcely match sales often enough to cause any considerable manipulation of price in the open market, without attracting the attention of other members. The Business Conduct Committee is constantly watching any peculiar price movements occurring on the Exchange, with full authority to investigate and report them to the Governing Committee.

A few other instances where there is danger of matched orders also deserve brief explanation. It may happen that a broker may receive two separate orders from two distinct sources over the telephone from his firm, one to buy and the other to sell the same security at the same price. To avoid any doubtful practices arising from such cases, the Constitution (Rules, Chapter I, Sec. 13) provides that:

When a member has an order to buy and an order to sell the same security, he must offer such security, if bonds at  $\frac{1}{8}$  of 1%, and if stocks at  $\frac{1}{8}$  of one dollar, higher than his bid before making a transaction with himself, if not so already bid or offered.

Other regulations limit the Exchange member, whether a specialist or not, in acting as both broker and dealer in the same transaction.<sup>21</sup>

**The Commission Law.**—The Constitution provides a schedule of minimum commissions for Exchange brokers, who may charge more but never less than the stated rates. Exchange members are also strictly forbidden to “split” or rebate part of their commissions with non-members; while Exchange members may share commissions with other Exchange members, the Constitution also provides definite minimum scales for such cases.<sup>22</sup>

These minimum commission rates vary somewhat according to the class and character of security handled, subject to minimum charges for small amounts. The commission rates are scaled up and down according to the higher or lower market prices of the securities bought and sold.

In general, New York Stock Exchange commissions, amounting as they usually do to only moderate fractions of 1% of market values, are well below the similar commission rates of the other leading stock exchanges of the world, and ridiculously small compared with the 25% and 50% commissions sometimes obtained in the commercial field. That this has always been the case is attested by the minimum rate of  $\frac{1}{4}$  of 1% mentioned in the original New York brokers' agreement of 1792<sup>23</sup>—a rate, incidentally, considerably in excess of the brokerage commission rates in the Exchange today.

Infractions of the minimum commission rate have always been severely punished by the Exchange, on the basis that cutting commissions below the minimum rate would be unfair to houses adhering to the rule, and would in the long run deprive the public of a uniform cost for the services of the market. A century and a quarter of experience has completely confirmed the opinion of the original brokers under the historic

<sup>21</sup> See Appendix VIIIId.

<sup>22</sup> See Appendix VIIIC.

<sup>23</sup> See Chapter III, p. 63.

buttonwood tree, that the American brokerage business in securities could not otherwise be conducted conservatively and safely. Without minimum commission rules, brokerage orders would constantly tend to flow into rash Exchange firms which, to secure business by cut-rate methods, would assume dangerous risks by reason of improperly small margins of profit. Not only would many disciplinary provisions of the Exchange be harder to enforce under such circumstances, but the insolvency of such firms would harm not only themselves and their customers, but also more conservative firms which had done business with them.

The provision against splitting commissions with non-members is a unique feature of the New York Stock Exchange among the leading security markets of the world, yet one for which in theory if not in practice this Exchange has been heartily envied by other markets. Not only does it check "money trust" tendencies in the market arising from the activities of corporate banks engaging in the commission business, but it also prevents the formation here of a miscellaneous class of "business getters" such as may be seen abroad, which is mostly beyond the control of the exchanges and sometimes irresponsible and harmful to them. The absence of these unnecessary middlemen in the New York Stock Exchange commission business largely accounts for the lower commission charges to the public here, as compared with those of the foreign stock exchanges to their respective clienteles.

Another rule of the Exchange<sup>24</sup> restricts the advertising of its members to "a strictly legitimate business character." A glance at the financial section of any leading metropolitan newspaper will reveal how thoroughly this regulation is enforced. Members of the London Stock Exchange are not allowed to advertise at all, but in the United States such a flat prohibition would not prove salutary, both because of the more extensive employment of advertising with us, and because of other even

<sup>24</sup> Constitution (Rules, Chapter VIII, Sec. 1).



more fundamental differences between British and American business.

**The Circulation of Rumors.**—Still another cause for constant vigilance by the Exchange authorities lies in its provision regarding rumors:<sup>25</sup>

The circulation in any manner of rumors of a sensational character by a member, in any case where such act does not constitute fraud or conduct inconsistent with just and equitable principles of trade, is an act detrimental to the interest or welfare of the Exchange.

In spite of occasional assertions to the contrary, this rule is enforced unsparingly and without favor by the Exchange. Yet its enforcement is from the nature of things difficult to effect, and of course can be carried out only with respect to members of the Stock Exchange. More than this the governors can hardly do, for they have no authority to regulate the conversation of everyone even on Manhattan Island, let alone other apprehensive and talkative sections of the inhabited world.

Rumors, as a matter of fact, never start on the floor of the Exchange but outside it; yet, since their effects are principally felt in the stock market, the opposite is commonly supposed. The tense and imaginative atmosphere of Wall Street is peculiarly liable to magnify trifles into bonanzas or catastrophes—but we must remember that the Stock Exchange and Wall Street are not synonymous. A rumor widely circulated by word of mouth (and in the press also, for that matter) some years ago concerning the supposed shaky financial condition of an old, conservative, and deeply rooted business house in New York, was, after a painstaking study, finally traced to a well-meaning but inaccurate trade publication in another continent.

The amazingly swift and accurate news service of the New York financial district, its impartial news tickers and keenly analytical financial press, have, of course, vastly reduced the ability of artificially circulated rumors to affect security and

<sup>25</sup> *Ibid.* (Rules, Chapter XIV, Sec. 4).

wholesale commodity prices, either upwards or downwards—and both price movements proceeding from such a cause are equally bad.

**Closing Contracts "Under the Rule."**—A further set of regulations<sup>26</sup> relates to the methods employed in closing contracts "under the rule." Such contracts are occasioned when a house either announces its insolvency, or fails to make deliveries of stock or payment for stock by the proper time. The member to whom money or securities are due but have not been delivered, is permitted to make a new contract involving the same transaction in the same security, and substitute it for the old contract which has not been fulfilled. Any profit or loss occasioned to the member who is forced to make such a second contract is credited or charged to the member who has failed to keep his contract. Owing to this method of closing contracts under the rule, unnecessary delay and risk by the party closing the contracts are eliminated.

**Suspension of Trading.**—It sometimes becomes necessary to halt the trading in securities upon the Exchange, either in a single security or in all securities. In the former case of an issue security, trading in it may be temporarily suspended, or it may be permanently stricken from the list, in the manner and for the reasons outlined more fully in a former chapter.<sup>27</sup> But upon two wholly exceptional and extraordinary occasions the entire Stock Exchange has failed to open its doors and all its operations have ceased.<sup>28</sup> This has happened only twice since 1792—in the panic of 1873 and at the outbreak of the Great War in 1914. So drastic a step has been resorted to only in an economic convulsion, when the maintenance of a security market beneficial to the public has been rendered an impossibility. Needless to say, to close the Stock Exchange requires the affirmative vote of the Governing Committee.

<sup>26</sup> See Appendix XVII.

<sup>27</sup> See Chapter IV, p. 105.

<sup>28</sup> See Chapter III, p. 72.

**Bucketshops.**—A “bucketshop” is a fictitious stock brokerage office which either pretends to execute its customers’ orders without actually doing so, or to carry such customers’ long commitments when actually it secretly sells them out at once after purchase. If the customer is mistaken in his opinion of the stock which he orders to be purchased, and it declines instead of rises, the bucketshop by pretending to sell it out at lower prices can appropriate the customer’s margin. In effect, therefore, the bucketshop makes it a practice to take a position in the market opposite to that of its customers; the French aptly term such firms *maisons de contre-partie*. “Bucketing” is of course a complete perversion of legitimate stock brokerage, and in its economic effects constitutes mere gambling and wagering on prices, rather than actual speculation.

This practice has always been strictly forbidden to Stock Exchange members, who are also prohibited from having any connections or business transactions with non-member firms engaging in such practices. The Constitution states:<sup>29</sup>

No member shall be directly or indirectly interested in or associated in business with, or have his office directly or indirectly connected by public or private wire or other method or contrivance with, or transact any business directly or indirectly with or for

- (1) Any bucket-shop; or
- (2) Any organization, firm or individual making a practice of dealing on differences in market quotations; or
- (3) Any organization, firm or individual engaged in purchasing or selling securities for customers and making a practice of taking the side of the market opposite to the side taken by customers.

Many years ago, the Stock Exchange found that non-member firms who were “bucketshops” largely depended, to maintain the fiction of being legitimate stockbrokers, upon the use of Stock Exchange tickers. By restricting the employment of these tickers through the Committee on Quotations and Commissions, the Stock Exchange has in consequence been

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<sup>29</sup> Constitution (Rules, Chapter XII, Sec. 11).

very largely responsible for the steady elimination of bucket-shops throughout the nation.

**Semi-Annual and Other Financial Statements.**—In 1922 the Stock Exchange inaugurated its policy of regularly inquiring into the financial condition of its member brokerage firms. In this connection the Constitution states:<sup>30</sup>

Members who carry margin accounts for customers shall furnish to the Committee on Business Conduct, upon its request, which request shall be made not less than twice in each year, a statement of his financial condition or that of his firm in such form as shall be prescribed by said Committee.

Subsequently, there was added to this demand (referred to in Wall Street as the Stock Exchange "questionnaire"<sup>31</sup>), the further requirement that the same firms should cause to be made a complete audit of their accounts and assets, including securities held for safekeeping. Exchange firms or members not carrying margin accounts for customers were also called upon annually and on demand, to report to the same Committee as to their holdings of securities for safekeeping.<sup>32</sup>

The adoption of this policy has undoubtedly proved one of the greatest forward steps taken by the Exchange in recent times. Insolvencies of Exchange members (see accompanying Figure 59) have been reduced to very low percentage proportions, during years when the similar percentage insolvencies among American national banks, among all American banking institutions, and among American commercial firms, have been unusually high.<sup>33</sup> Frequently, the operation of the plan has prevented insolvencies on the Exchange, by forcing its firms in sufficient season either to increase their capital or reduce their commitments.

In 1926 the further policy was undertaken of calling upon Exchange members to furnish to the Exchange their total net

<sup>30</sup> Constitution (Rules, Chapter XV, Sec. 1).

<sup>31</sup> The full text of the questionnaire form will be found in Appendix XVIg.

<sup>32</sup> See Appendix XVIIh.

<sup>33</sup> See Appendix XVIIi.

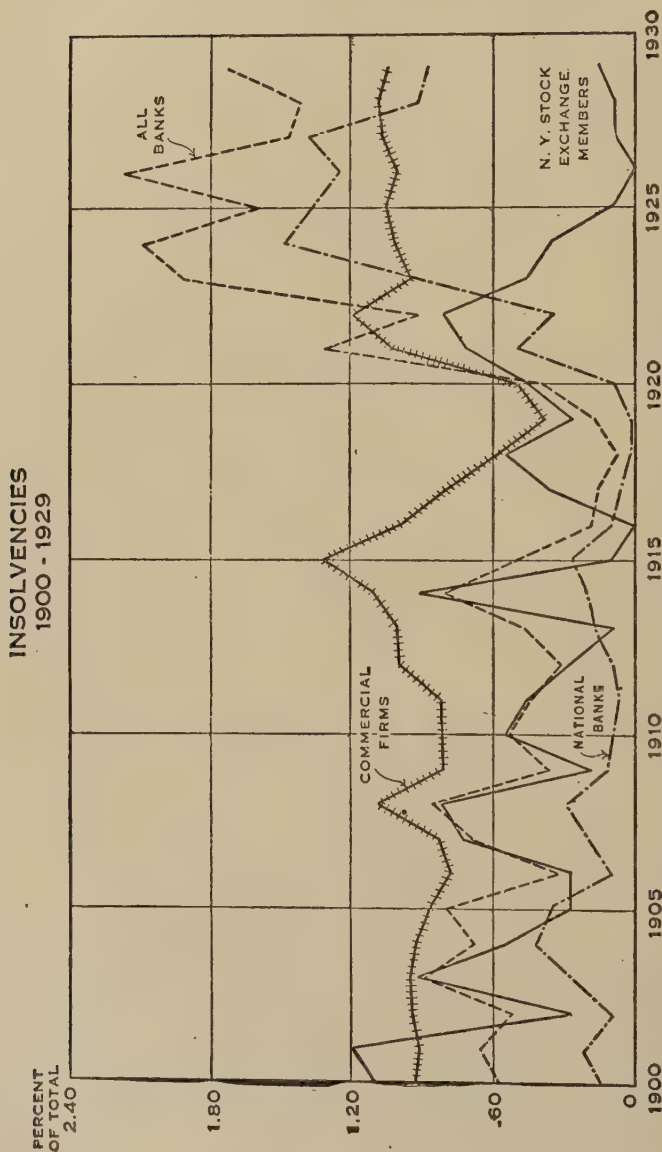


Figure 59. Percentage of Insolvencies in the United States

Showing annual percentages of insolvency among commercial firms, all American banking institutions, national banks, and New York Stock Exchange members. Based on statistics in Appendix XVIg.



borrowings on security collateral in New York. The effects of this collection and publication of "Stock Exchange loans" have been already reviewed.<sup>84</sup>

**Past Criticism of the Stock Exchange—Question of Incorporation.**—The Stock Exchange has by no means escaped criticism and even governmental investigation in the past, both with respect to the nature of the services which it daily renders, and to the manner in which its business is conducted and administered. On the whole, the Exchange is today undoubtedly the gainer by this searching criticism; it has adopted in toto several practical and constructive suggestions made to it, and has successfully adapted others to improve its methods in a practical way. But unfortunately, during the course of the Hughes Committee investigation of 1909, the so-called Congressional "Money Trust" investigation of 1913, and the hearings on the proposed Bill S. 3895 before the Banking and Currency Committee of the United States Senate in 1914, many inaccurate criticisms of the Exchange were uttered and given widespread publicity. Fanciful remedies for fancied grievances also were not merely proposed, but urged with insistence. Some of these have already been dealt with in the preceding pages. It remains necessary here to examine the proposal to force the Stock Exchange to incorporate.

The mystical benefits of incorporation have been vehemently urged with a rhythmical recurrence which is analogous to the tidal swings of the stock market, and which has perhaps been occasioned by them. For every bear market results in financial losses and indignation on the part of speculators, who, being unable to retaliate upon the intangible laws of economics, vent their feelings upon the tangible Stock Exchange. Someone, as by a stroke of inspiration, cries "Incorporate the Stock Exchange," and again it becomes necessary to point out the fallacy of this alleged method of inaugurating Utopia.

The Stock Exchange is regulated by law to the extent of

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<sup>84</sup> See Chapter XI, p. 279.

the law's constitutional limitations.<sup>35</sup> As an association, subject to the laws of the state, it possesses enough property to satisfy any ordinary claims against it. As a market place it is subject to the law of the State of New York, many of whose statutes relate to the stock brokerage business. Recourse from the decisions of its Governing Committee can always be had to the courts of the land. The Stock Exchange is consequently just as subject to the law as an association as it would be if incorporated, and no benefits in this respect would therefore be derived from incorporation.

**Instant Action Necessary.**—The Stock Exchange has consistently opposed forcible incorporation not because of hostility to proper governmental regulation but for entirely different reasons, which inevitably arise from the nature of the business conducted beneath its roof. To begin with, there is the very important necessity for swift and expert decisions. The Stock Exchange more than any business organization on earth demands instant action. The administration of the stock market cannot be paralyzed, not merely for six months but sometimes even for a matter of minutes, without grave dangers. It is the balance wheel of irresistible tides of emotional public feeling. Cripple its power to steer and brake itself, and it might well become a public menace instead of a public benefit.

As it is, instant action can be taken in the conduct of its affairs by experts in a highly technical and complex business, who are responsible and can be subjected to the processes of the law later on, if need be. The present safe and efficient methods are in striking contrast to what might happen were the Exchange incorporated, and subject in a crisis to an injunction by an irresponsible party or a national enemy. It is generally appreciated that in the unprecedented summer of 1914, the governors of the Stock Exchange literally averted what might have been the most appalling panic in our history, by

<sup>35</sup> See "Regulation of the Stock Exchange," pp. 556-557.

closing the Stock Exchange at the psychological and economic moment.

Neither are such occasions when instant and expert action is needed only to be found at the outbreak of wars. In the everyday conduct of the Exchange there must always exist authority, complete and unhampered, to act without a second's delay. There was no war in the fall of 1920, nor any epoch-making international crisis. Yet at noon on September 16, 1920, a tremendous explosion occurred only a few score yards from the Stock Exchange building, which shattered the windows throughout the heart of the financial district and killed some forty men, women, and children. Only the lowered curtains in the lofty Stock Exchange windows prevented possible casualties upon its floor. At once the news of the explosion was flashed over the tickers to all parts of the country. In the light of the subsequent severe but gradual decline in security prices, it is not unreasonable to imagine that, had the Exchange attempted to remain open that day, an avalanche of selling orders might have swept into it from all parts of the nation, and a narrowly averted panic might well have occurred then and there.

Fortunately, the President of the Exchange almost instantly rang the gong and suspended trading, and shortly afterward the governors, convened in special meeting, voted to close the Exchange until the morrow. Had the authorities of the Exchange, who handled that dangerous and wholly unexpected crisis so effectively that today it has been almost forgotten, been restrained by the restrictions to which, by the terms of their charters, many incorporated bodies are subject, there might have been a very different story to tell. The Stock Exchange members heartily share with the public a distaste for panics. It is small wonder that they do not agree with the recurrent proposal to incorporate the Exchange.

In the panic of 1929, the whole community benefitted by the freedom of action possessed by the Stock Exchange

authorities, and their ability to provide in some cases quite novel but effective remedies for the often very unusual problems of that trying period.

**Enforcement of Discipline.**—A less fortuitous but perhaps even graver danger which would result from incorporating the Stock Exchange, would be that its present morale and its strict discipline over the conduct of its members would be profoundly shaken and impaired. We have seen that the regulations of the Stock Exchange relating to the business conduct of its members go even beyond the common law in the earnest attempt to maintain "just and equitable principles of trade," and that these regulations are immediately and thoroughly enforced. From the inherent nature of the transactions which take place in an organized securities market, such a high and ethical spirit of legislation is necessary. The general recognition of this necessity by Exchange members, in fact, is responsible for the severe and instant punishment to which they have voted to make themselves liable.

Under a legislative charter the terms of membership and the relations of the members to the governing body of the Exchange would be subject to legislative control, whereas they are now a matter of contract. The present disciplinary power of the governing body is based on this contractual relationship. Under the contract fixing the terms of membership every member agrees to observe the rules of the Exchange and submits himself to the jurisdiction of the Board of Governors to punish any violation of the rules by fine, suspension, or expulsion, as the case may be. The most effective of these rules are couched in the broadest language to bring within their sweep not only acts that are wrongful from a legal point of view, but also acts that are inconsistent with fair dealing and in any way detrimental to the Exchange as a great market for securities.<sup>86</sup>

As Mr. Horace White, chairman of the Hughes Commission, expressed it, "Forcing upon the Exchange an act of incorporation would impair this disciplinary power and involve the Exchange in extensive litigation at heavy costs without any

<sup>86</sup> See "Regulation of the Stock Exchange," p. 557.

advantage to the public.”<sup>37</sup> The morale which exists on the floor of the Exchange is not a condition isolated from and unrelated to the prosperity of the nation. It is a national asset, and performs economic services of profound benefit and significance to all classes of our population. Any disruptive and weakening force exerted upon the organization or standards of the Exchange would consequently constitute a drag upon the economic progress of the United States.

But the danger to the public from an incorporated Stock Exchange would not be merely general and abstract. Apart from the profound public harm, as outlined above, a constant liability of personal and individual injuries would likewise ensue. Why should the investing public, it might be asked, be compelled during years of litigation to make contracts for large sums through their brokers with a possibly unscrupulous member, whose very solvency might easily be impaired while his case unavoidably hung fire in the courts? Yet this would become a disquieting possibility were the present summary powers of the governors crippled by incorporation of the Exchange. In this, as indeed in other respects, the interest of the public is consequently much more adequately protected in its dealings in the Exchange under its present régime, than could possibly be the case under an incorporated Exchange. It has nothing to gain and a very great deal to lose by incorporation.

**Not a Profit-Making Organization.**—The Stock Exchange is quite unlike the typical business partnership or corporation. It has never sought or obtained any special franchise from the state. It is not a “monopoly,” for it is in active and sometimes unsuccessful competition with other markets. It is not run for a profit, but simply as a facility to its members and their customers. Financially speaking, it only aims to pay its expenses. Its members’ income is derived from their personal business, and not unnaturally they are best satisfied when their dues to the Exchange are lightest. Corporation laws, which

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<sup>37</sup> *Ibid.*, pp. 294 and 557-558.



are primarily aimed at institutions run for the maximum obtainable profits, are therefore in many ways inapplicable when applied to such an organization. With members located all over the nation, the Stock Exchange has the same interest as the public at large in the conduct of its affairs, rather than a local and specialized interest opposed to the public interest.

In concluding this scanty and yet already overlong discussion of the dangers of incorporating the Exchange, the fact should be noted that the Hughes Investigation of 1909 refused to recommend incorporation,<sup>38</sup> and that after a careful investigation by the British Royal Commission of 1877, the London Stock Exchange was likewise not required to incorporate, but was permitted to continue its internationally beneficial work as a voluntary association.<sup>39</sup> In both the two largest stock exchanges of the world,<sup>40</sup> then, as indeed in smaller ones, the argument for forcible incorporation has been thoroughly exploded.

**Jurisdiction of Stock Exchange.**—We have seen that the Exchange is essentially a market place with rules for the maintenance of “just and equitable principles of trade” therein. Over its membership it has full and necessary power, but there its authority naturally and rightfully ends. John R. Dos Passos, an acknowledged authority on the laws of the Wall Street securities markets, declared that the jurisdiction of the Stock Exchange should be confined and limited “to those matters which arise between its members in the course of their business with each other as brokers; otherwise its judicial powers might be extended to embrace every affair of human life, which was never intended and which the law would not permit.” And this general position in regard to its proper jurisdiction, the Exchange itself takes also.

The possible extension of the Exchange’s powers, curiously enough, has been urged more strongly by amateur critics than

<sup>38</sup> See Appendix XVIj.

<sup>39</sup> See Van Antwerp, pp. 231-234.

<sup>40</sup> See Appendix XVIk.

by the Exchange itself. Frequently in the past they have attempted to make a club of the theoretically possible but undesirable extension of the Exchange's listing powers to regulate evils, real or fancied, in our larger corporations. Of course, no Exchange in the world has ever been made use of in this way, or ever should. The Exchange is clearly conscious of the fact that no one has appointed it to supervise the affairs of all listed corporations, to discriminate among the customers of its members with a superhuman and infallible eye for hidden motives, oversee all the banks and financial institutions of all kinds in Wall Street and elsewhere, and to try to change the fundamental and eternal laws of economics to suit the erstwhile complainant's every passing whim. Indeed, should the Exchange be foolish enough to rush in whenever someone indignantly demands, "Why doesn't the Stock Exchange stop this?" the other camp of critics might for once have some justice behind its ancient and threadbare but ever-recurring outcry against the "tyranny of Wall Street," etc., etc.

**Responsibility to Public Keenly Felt.**—The Exchange sticks to its last. It maintains a market place, and enforces just and equitable principles of trade within it. Yet the Exchange has always been ready and willing, so far as its inherent limitations permit, to cooperate in any movement looking to the benefit of the investing public. Something has been said regarding the unremitting and successful fight it has waged against security swindling.<sup>41</sup> While a very conservative force, it none the less has always been emphatically patriotic and public spirited. The Exchange realizes its essential community of interest with the public and its responsibility to the public. The governors of the Exchange take vastly more concern over this responsibility than the public usually realizes.

The present organization of the Stock Exchange has, as we have seen, resulted from an intensely practical and varied experience since 1792. The vast spread of corporate enter-

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<sup>41</sup> See Chapter IV, p. 120.

prise in America since 1830 is in itself a pragmatistical tribute to the management as well as the work of the Exchange. Another impressive tribute is likewise furnished by the steady growth and extension of the Exchange system to all parts of the country. Ill-managed and economically dangerous institutions do not continue to grow in this way from century to century.

## CHAPTER XVII

### THE STOCK EXCHANGE AND AMERICAN BUSINESS

**Sensitiveness of Security and Money Markets.**—Practically every significant economic force in America, and the principal economic factors in the life of foreign nations as well, make their influence felt instantly and often in advance, upon the course of the security prices established on the floor of the New York Stock Exchange.

The newcomer in Wall Street is always astonished at this tremendous sensitiveness of the money and securities markets to domestic and foreign happenings, present and future. Stock Exchange prices fluctuate as constantly and as unexpectedly as life itself, and possess some of the inevitable rhythm of progress. Not only crop reports and crop prospects, banking and money conditions, steel production, commodity prices, and the lurking possibilities of war, but also labor conditions, unemployment, strikes present or prospective, idle freight cars, business failures, interest rates, building reports, retail sales, the legislative enactments and judicial decisions of Washington, and a thousand other events—all directly and profoundly affect the course of security prices on the Exchange. In addition, the stock market must reckon with all manner of cabled foreign news, the British bank statement, changes in French taxation, the production of gold in the Rand, of copper in Spain, of tin and rubber in the Straits, the foreign exchange rates, the foreign exports and imports of this and other leading nations, and the decisions and strategy of the chancellories of Europe.

A well-known banker was once found pacing up and down his Wall Street office in evident anxiety. When asked what

the trouble was, he declared that "the Indian monsoon was not blowing well." When his interviewer failed to see the connection between the climate in India and the banker's business in securities he was told, "If the monsoon fails, there will be a drought in India, and the bazaars will be forced to sell silver. If oriental silver comes on the market, it will depreciate the oriental exchanges, which are founded on silver. This will in turn temporarily ruin the market there for cheap British textiles, because it will decrease the buying power of the purchaser's money. If the Lancashire district in England slows down, it will not buy textile machinery, and I am vitally interested in the stock of an American company making textile machinery." Far-fetched as this chain of hypotheses may seem, nevertheless almost exactly this sequence of events actually occurred some months afterwards. It is consequently natural that a leading tenet in the philosophy of Wall Street men is the old adage of the Greek philosopher, Heraclitus, to the effect that "all things flow," and that the only changeless feature of life is the principle of change itself.

**The Wall Street Point of View.**—From one standpoint the vision of Wall Street, and of the business men all over the country who do extensive business there, is as wide as the world, as deep as the deepest mineshaft, and as high as the loftiest soaring aeroplane. And yet, because its inhabitants and its customers are human beings, its viewpoint is in many ways limited and parochial, too. The intense stress and strain under which most men live there has made them only too apt to credit glib assertions and superficial deductions, and to have a highly specialized yet hazy and limited conception of the vast economic forces which converge upon the narrow Stock Exchange floor. Men who year after year are cliff dwellers in the great gray canyons of the New York financial district are through force of circumstances often unable to look further into the future than the prices on the stock ticker. This often amounts to seeing into the future some three to six



months further than many business men do, yet of course the thoroughgoing student of practical business economics would not wish to confine his attention solely to it. And as it is with the vision of Wall Street men, so it is too with their temperament. When ticker prices climb, they are joyous optimists, but the next day, when the ticker reports declining prices, they become sad and melancholy indeed.

But if the average Wall Street man is in a human way the victim of intense specialization and absorption in his own immediate environment to the exclusion of a wider and deeper understanding of economic forces and tendencies, the same thing may be urged against the average American business man who judges the work of Wall Street only from rumor and hearsay evidence. Manufacturers often wonder at the occasional gyrations of their stocks in the stock market, and their habitual assumption that somehow or other the Stock Exchange itself must be responsible for them is a fallacy as natural as it is erroneous.

**No Royal Road to Understanding Price Changes.**—The real understanding of prices and price changes in our organized markets involves not so much romantic mysteries or astonishing human-interest stories, as a painstaking and unenlivening study of the "dismal science" of economics. The student must become familiar with abstract conceptions and much technical terminology; he must pore over many initially bewildering statistical tables and graphic charts; and in addition he must gain by equally laborious means a knowledge of many markets and marketing methods. In this formidable and superficially dull undertaking there are no short-cuts or simple but secret formulas, nor, despite the assurances of those philanthropic individuals who occasionally advertise "How to make money in the stock market in 10 easy lessons," is there any royal road to learning.

**The Universal Habit of Personifying.**—Now the great majority of mankind, whether through preoccupation or laziness,

ness, is not and never will be deeply moved by abstract philosophers or recondite economists. We all of us base our opinions on every conceivable subject, not upon the results of hard, slow, and painful thought and study, but upon the whispered rumor, the contagious suspicion, or the vehement, picturesque, and reiterated accusations of the fiction-writer. Moreover, being still only some hundred generations removed from barbarism and savagery, we all still have deep in our methods of thought that instinctive habit of personifying everything, which the scientists call "anthropomorphism." For primitive and ancient man always personified as human beings those abstract forces in life and nature which he could not otherwise comprehend, and modern man in hundreds of ways still follows in his footsteps.

The ancient Greek, for example, without our scientific knowledge, was naturally puzzled in trying to determine why the sun rose and set, why there were storms over sea and land, or why the seasons recurred in endless succession. As we know, he finally concluded that in each instance some semi-human, semi-divine person was responsible for it all. The sun consequently came to be thought of as a charioteer who drove flaming horses across the sky, and the winds as winged beings who flew through the air. Thus, a whole pantheon of pagan gods finally resulted from the primitive man's inability to think in abstract, scientific terms about the universe.

So, too, the American Indian who could not understand the destructive and terrifying force of the lightning, finally decided that there must be a personal devil behind it, who, for all his evidently superior powers, was after all only another Indian like himself with a more cruel and disagreeable disposition. This natural theory proved so satisfactory that thereafter he had not the slightest doubt that he really understood practically everything worth while knowing about lightning.

**Modern Myths and Myth-Makers.**—This plunge into ancient myths and myth-making is not such a digression from

the ways of current thought, both in Wall Street and out of it, as might at first appear. Every modern man also personifies the abstract forces of life, of nature, and even of international politics. Uncle Sam and John Bull are much more real individually to millions of people than—say—the Comptroller of the Currency, or the Chancellor of the Exchequer. And when it is not as vivid and graphic a matter as international relationship, but instead the dim and dreary realm of economic forces, how natural and inevitable it is that we should all more or less yield to the old instinctive tendency of personifying the abstract forces of the shop and the market place which, without hard and difficult study, would otherwise elude our understanding.

Wall Street, therefore, has its own mythology, and a very colorful and picturesque mythology it is! The chief demigods in this modern financial pantheon consist of the imaginary group of "Men Who Put Prices Up and Then Put Them Down Again." For prices certainly rise and fall, and somebody must be consciously responsible for it! It is useless to point out that the Exchange is a national market, and that prices established there result from the transactions of thousands and thousands of people all over the country. These thousands of people cannot be visualized, and so honestly indignant and sincerely superstitious individuals heatedly declaim against these mythical figures, as "a little clique in Wall Street," or "the powers that be." Even the broker's clerk, who ought to know better, murmurs as he watches the tape, "I see They are putting prices up again."

It is as useless to talk about supply and demand, or interest rates, liquidation, or prospective earnings to these simple souls as it would be to mention the theory of sidereal revolution to the Greek worshipper of Apollo, or the theory of air currents and electricity to the Indian worshipping his lightning devil. And so the Stock Exchange, at least in many men's minds, is thronged with a ghostly and devilish company of "insiders," "big manipulators," "operators," and "scalpers"—lineal descendants, all of them, of Satan, Mephistopheles, Beelzebub,

and every other pleasing personification of the forces of evil that mankind has ever evoked in order to shudder at. Particularly villainous in this demonic financial company is the "bear raider," who in the popular mind combines the daring bloodthirstiness of Captain Kidd with the grisly hideousness of Fi-fo-fum. Such conceptions are an immemorial heritage of the human imagination. After the bear raider has changed his smart metropolitan attire for a tropical costume, the West Indian negro voodoo-worshipper is waiting to sacrifice his white cock to him. And so it goes.

**The Human-Interest Factor in News.**—If these supposed personal factors in the stock market are to such a degree mythical and imaginary, it might well be asked why the papers continually give this personal flavor to what should be a cold, impersonal, and statistical account of the stock market. The younger and less experienced reporters and editors can hardly be blamed if they quite sincerely believe some of the commoner myths of Wall Street, particularly when it is realized that even members of the Exchange themselves occasionally lapse into this almost instinctive and yet fallacious mode of thought. The older financial writers, as a matter of fact, are well aware of the impersonal economic forces which really create Stock Exchange prices. Nevertheless, they help more or less to keep alive these superstitious myths which haunt the market place, because after all they have to write in a language which the great mass of people can understand. If an editor states that, "The short interest having been depleted by previous covering, liquidation and short selling found little resistance, and lower prices resulted," he might in a given case quite accurately describe the factors in the market making for a price decline. But lest such technical abstractions prove "caviar to the general," he will usually garnish his report with an inaccurate but vastly more appealing human-interest motif. He will hint at "a prominent bear raider" to whom the decline may be attributed, or suggest that the "Waldorf crowd" or the "Palm Beach

crowd" or "the West," or some equally far-off and indefinite set of men, had "decided to smash prices." This suggestion of a deep-laid plot by mysterious conspirators is as old as Hindoo mythology, and rarely fails of popular appeal—witness the motion pictures! The editor's position has been stated quite candidly by a well-known financial journalist:<sup>1</sup>

It is always easier to say that the market is going down because it is being raided by powerful and conscienceless bears than merely to call attention to the undoubted fact that no one wants to buy stocks. It not only sounds better, it reads and writes more easily. The writer knows what he is talking about, for he had to fill a column in a New York newspaper with stock market gossip every day for five or six years.

The public must always personify what is going on. There is no way of personifying the cold fact that people do not want to buy stocks, and a financial editor cannot find new ways of stating this naked, unadorned and comfortless truth every day in the year. But once you introduce the bear, there is something the public imagination can fasten itself upon.

**Effect on the Public Mind.**—The effect of such picturesque financial columns on the general public is only too evident. Amid the murky fog of vague and unfamiliar economic and financial terms which he doesn't understand, the average citizen finds, in this human side of the story, something that he can really comprehend. Prices went down and some mysterious person did it—that to him is the crux of the matter. Unless he makes so thorough and complete a study of the economics of the stock market that he can realize what absurd nonsense this personifying of economic forces really leads to, the more he investigates the mystery, the more strange and mysterious it all becomes. He never learns who the "Palm Beach crowd" is, or exactly how even the Argus-eyed editor knows that it is responsible for the decline. Neither is he ever told who the real "insiders" in the market are. Many knowing nods, wise looks, and vaguely cynical adages he may encounter, but

<sup>1</sup> See Albert W. Atwood, "Vanished Millions," *Saturday Evening Post*, February 26, 1921, p. 9



no genuine information. And so the mystery deepens and the greater grows his superstitious fear and hatred of the imaginary demigods and demons of Wall Street. This is human nature—but it is not economic fact.

**Services of the Stock Exchange to Investors.**—In previous chapters the functions and benefits of the Stock Exchange as they touch society generally, have been described with abstract and dull veracity. In the present chapter the attempt will be made in the same unromantic but truthful fashion to particularize and speak more specifically of the contacts which the Stock Exchange has with different types of men and of business. For even at the risk of repeating in other words much which has been said before, it seems essential to summarize the many powerful though often indirect links which exist between stock exchanges on the one hand, and on the other even those sincere but ill-informed persons who regard them with undisguised horror.

First of all, a word concerning investors and investment is called for. Previous chapters<sup>2</sup> have sufficiently recounted the services to investors rendered by the Stock Exchange to make unnecessary their reenumeration here. But we should realize that in one way or another a vast majority of Americans are investors. The number of people who directly invest in small lots of stock<sup>3</sup> or in small amounts of bonds<sup>4</sup> has experienced an astonishing growth of late, and has recently been estimated at 17,000,000 in the United States.<sup>5</sup> But in addition, additional millions of individuals today invest their savings in listed securities by proxy, often without knowing it. Only a relatively small proportion of the hundreds of thousands of people who have savings accounts realize that the banks are able to pay interest upon their accounts only through reinvesting their money largely in listed securities. Both our savings banks and our commercial banks are among the largest insti-

<sup>2</sup> See Chapter II, p. 41; Chapter IV, p. 93; Chapter VI, p. 166; and Chapter XVI, p. 469.

<sup>3</sup> See Chapter IX, p. 252.

<sup>4</sup> See Chapter X, p. 272.

<sup>5</sup> See Appendix XVIIa.

tutional investors in this country and are an important factor in the Stock Exchange bond market.

So it is, too, with the insurance companies, whose enormous assets are largely invested in Stock Exchange securities. The economic importance of insurance to the country today as a stabilizer of the risks of death and disaster to property is generally realized, yet the assistance which the Stock Exchange gives to this beneficial business is often forgotten. The ability of the insurance companies to pay their policyholders promptly largely depends upon the ability of the Stock Exchange to render its listed securities speedily negotiable.

**The San Francisco Earthquake.**—A striking instance of this fact was afforded in the great San Francisco earthquake. At that time the ease and readiness with which the insurance companies indemnified their policyholders caused very general and flattering comment. Yet the fact that the companies were able to get cash mainly by liquidating securities in the Stock Exchange, and that no small part of the economic burden imposed by the great catastrophe consequently fell on the organized securities market in New York, is not so often remembered. Many men and many companies carry insurance, not only as a protection, but as an investment, and in large measure they unconsciously depend upon the steadiness and liquidity which the Stock Exchange imparts to its listed securities.

**Importance of Agriculture to the United States.**—Coming now to the different American occupational classes for whom the Stock Exchange renders a daily though often little recognized service, one should at once recall our great farming population. The tremendous economic significance to this country of our vast and fertile fields, and of our great and progressive farming population is sometimes overlooked in the turmoil and clamor of city life. When the city dweller delves into statistics, when he learns of the several "billion-dollar crops" which these men raise each year, and their importance to our entire foreign and domestic commerce, or when he dis-

covers the vast quantities of city products which are purchased annually by American farmers, he begins to realize that this nation, in spite of its huge and increasing industrial progress in recent years, is still largely an agricultural country. The national functions of the Stock Exchange, as a matter of fact, are in no way more clearly emphasized than by the services which it renders to farmers all over the United States.

The latter of course benefit from its operation to some extent simply through being investors, although it is of course true that the favorite farmer's investment is, and may always be, the farm mortgage. Still, the idea that all farmers are overcredulous victims of the stock swindler's wiles is far from the truth. Some farmers are as shrewd judges of sound securities as could easily be found among most other classes of American business men. Moreover, farmers invest indirectly to an even greater extent by holding savings accounts and insurance policies in great numbers and for large aggregate sums.

Undoubtedly, however, the relationship between the Stock Exchange and American agriculture is less close than with other American industries, for the reason that American agriculture has thus far only in rare instances organized itself in corporate form, and in consequence cannot like other industries seek capital through the Stock Exchange. But, as a President of the New York Stock Exchange has pointed out,<sup>6</sup> this is not wholly a Utopian prospect for future years, and if agricultural shares could be distributed more extensively through the Stock Exchange, it would enable the American farmer to obtain partnership capital which he really needs, instead of loans which only plunge him deeper into debt.

**The Stock Exchange and the American Farmer.**—The principal assistance which the Exchange has been able to render the farmer consists of having been so largely instrumental in establishing the machinery of transportation upon which the

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<sup>6</sup> See Appendix XVIIb.

agricultural communities must depend to sell their produce. The farmer who sends his wheat to market over the iron pathway provided by our western railroads benefits unconsciously and yet profoundly from the work accomplished by the Stock Exchange during the preceding half-century in marketing and distributing our railroad securities. The American farmer could obviously never have become the progressive and, compared with the agricultural workers of other countries, the extremely prosperous individual that he is, were it as difficult for him to market his produce as it is for farmers in other less developed countries. Without the network of steel rails stretching all over the United States, he would be engulfed and isolated in its vast interior areas, as are the peasants of Russia or China.

But the problem of marketing the great crops of this country does not simply consist of getting them aboard the freight cars. Many other factors are also involved. There is the country bank, which finances the farmer's undertakings and often preserves itself from illiquidity and even insolvency by keeping a certain part of its surplus funds invested in stock market loans.<sup>7</sup> In addition, there are still other vital parts of the crop-marketing machinery beyond the blue horizon of the farmer's world. The elaborate mechanism of foreign exchange and foreign trade, the exporting, shipping, and insurance companies have to perform their separate parts of the work. And to each of these additional factors the Stock Exchange renders one important service or another.<sup>8</sup> Thus, while the Exchange has nothing to do directly with marketing the farmer's wheat, corn, or cotton, nevertheless it renders indirectly a hundred often unnoticed and yet genuine services.

**The Modern American Farmer's Needs.**—Nor does the contact between the stock market and the farmer end here. For the American farmer of today has in many ways become an agricultural engineer, who uses machinery extensively and to an

<sup>7</sup> See Appendix XIk.

<sup>8</sup> See Chapter XVIII.



increasing extent in place of the slower and less profitable manual labor employed in our fields fifty years ago, which is still so employed in most other countries. If the industrial portions of this country have imposed a constant burden upon our farmers by attracting their labor into the cities, they are repaying the debt by furnishing the farmer with iron slaves capable of outworking hand labor as to speed, efficiency, and cheapness. Nowadays, machinery can be depended upon to shell and grind corn, plant, reap, and shock wheat, cut silage, hoist hay, thresh grain, and perform many other tasks essential to wholesale farming. Neither has the farmer's wife been slow to adopt such mechanical, labor-saving devices for her churning, washing, milking, and separating.

All these invaluable machines are manufactured by corporations, many of the larger of which have in the past depended upon the Stock Exchange for their capital. Still other corporations which have similarly financed themselves furnish the farmer with various petroleum products, fertilizers, tractors, etc. Moreover, apart from the tools of his trade, the farmer is enabled, along with the city dweller, to obtain the innumerable comforts and luxuries of life through corporations with listed securities. These days the farmer drives his pleasure car, uses a telephone, buys merchandise by mail from the great mail order houses, employs electric lights in his home and in his barns, and enjoys the artistic and educational programs brought to him by his radio. In the creation of all these things, also, the Stock Exchange plays an indirect but essential part.

For all the perennial misunderstanding which has existed between town and country even before the days of Horace, the farmer is a hard-headed thinker, with a firm and stubborn grasp upon the realities of life. He is a conservative and constructive individualist. It is a real tribute to his sound sense that Socialism and its glib theories about abolishing property and the like almost invariably make little appeal to him. Even in Russia this has been so, for although Bolshevism swept the cities and towns, it has made little real progress out in the coun-



try. Now the average American farmer has been bombarded too long and too steadily with misleading and distorted statements concerning the Stock Exchange to have a clear idea of just what it is or what use it serves. Offhand, he might perhaps be inclined to suspect and condemn it on this fallacious yet oft-repeated hearsay evidence. Yet the fact remains that the Stock Exchange has played a continuous and highly important part in making American farmers generally the most progressive and prosperous class of agricultural workers in the world.

In recent years, much of the American farmer's trouble has arisen from his difficulty in marketing his surplus production abroad, in competition with other nations whose land and labor are cheaper than our own. It is consequently of vital importance for the American farmer to lower his production costs. The invention and employment of labor-saving agricultural machinery, whose creation is so largely facilitated by the Stock Exchange, is thus likely to prove of more fundamental assistance to our farmers, than new legislation for extending fresh credits to him, or for vainly attempting to establish artificially high prices for his products.

**American Labor's Stake in the Stock Exchange.**—When we pass from the country to the city the connection between the Stock Exchange and the daily lives of the city dwellers becomes even more direct, graphic, and thoroughgoing. The working man's very employment, in fact, is tied up with general conditions in industry and trade which depend to so large a degree on organized security markets. A former writer<sup>9</sup> upon the Exchange has clearly and trenchantly explained this connection:

The last census shows that 32½% of the population of the United States is composed of laboring men, not counting agricultural workers. This large army of men is by no means independent; on the contrary it is strictly dependent on the ability of others to give it employment. Shut down the factories, curtail the operations of railways, close the mines and quarries, stop building and new construction, and in greater

<sup>9</sup> See Van Antwerp, pp. 42-43.

or less degree suffering and privation among these large masses must ensue.

Now go a step further, and we find that the managers of these railways, mines and factories are in turn dependent—wholly dependent upon capital. They cannot go ahead with the extensions and improvements necessary to efficiency without borrowing money; and credit, in turn, will not come to their support unless a broad market is provided, through the Stock Exchange, for the securities which represent these obligations. Hence we see that just as every farmer in the West and every cotton-grower in the South must have a stable market for his products, so every laborer in our great industrial field is directly concerned with the maintenance of a stable market for the securities of the company that employs him. The interests of one are the interests of all, and speculation, in one form or another, underlies all industrial progress.

From the previously recited fact <sup>10</sup> that the Stock Exchange stabilizes the flow of capital into industry, it follows that it likewise is an indirect but powerful force in stabilizing the conditions of employment, and thus performing a genuine though little recognized service to the laboring man.

It would also be well for the Stock Exchange member to realize that his own organization is historically descended from the mediæval guilds, and is in certain respects a species of labor union today. Stock Exchange members cannot condemn limited hours of work, minimum wages or commissions, central gratuity funds, limited membership, collective bargaining, and several other familiar features of the laboring man's trade union, without condemning themselves. Similarly, it may be surprising to the unionized laboring man that there is in the very heart of capitalistic Wall Street an old and not insignificant institution to which these things are the regular and accepted rules of daily business.

**The Worker as an Investor.**—In addition, the employed classes are rapidly becoming investors. They are absorbing small lots of stocks and bonds, and investing in other listed securities by proxy through savings bank accounts and insur-

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<sup>10</sup> See Chapter II, p. 52.

ance policies. The fact that many far-sighted and progressive corporations are encouraging their employees to become stockholders by purchasing the stock of the employing company, and the possibility of largely composing the difficulties which arise between capital and labor by thus merging the two classes, has already been pointed out.<sup>11</sup>

But there is also a profounder although even more imperceptible service which the organized markets render to the laboring classes. Owing to the ability of these organized markets to finance increasingly efficient means of production, the purchase price of goods has been gradually cheapened in terms of wages and salaries, with the result that the standard of living has gradually been raised.<sup>12</sup> We shall say something later in the present chapter concerning this great although indirect and slow-moving service of the organized markets, and particularly of the Stock Exchange, to labor. If the working classes realized the full value to their economic status of the Stock Exchange, they would be the first to spring to its defense when it is unjustly assailed.

**The Stock Exchange and Our Middle Class.**—Passing on to our so-called “middle class”—our tradesmen, salaried executives, doctors, lawyers and the like—the Exchange likewise has its appropriate service to perform for them. The typical fairly successful man derives in many respects the same general benefits from the Exchange as does the laboring class. But as a rule he experiences more fully the problems arising from the saving and accumulation of wealth. With the first few thousands he saves, he will probably buy real estate, get his life insured, and start a savings bank account, thus at least becoming a security investor by proxy. But after that point has been passed the problem of how to invest his money safely and yet profitably becomes a vital rather than merely an incidental part of his economic existence. The problem may be intensified by his inheriting money from relatives. If he is overcredulous

<sup>11</sup> See Chapter IV, p. 119.

<sup>12</sup> See Chapter II, p. 52.

the stock swindler may do him harm. If he is reckless or unwise, speculation in the Exchange or elsewhere may injure him and his family. But if he pursues this business—and it must be looked upon as a business—of investing his surplus savings carefully and intelligently, the Exchange opens to him the means of securing the best and most negotiable security investments in the country. And this continual investing on his part—together with such successful speculations as he may make—are an economic benefit, not only to himself but to the whole community, since he provides the capital so steadily needed for the development of our industries.

**The Purchase of Income.**—The ease with which modern man can buy income is, in fact, one of the most significant testimonials to our economic progress in the past two centuries. In the late seventeenth century the father of the poet, Alexander Pope, who had been a highly successful London merchant, decided to retire from business. From his experience he was fitted to know of the best existing methods of investing his money so as to enjoy his old age comfortably and securely. Yet the best scheme Pope *père* could hit upon was to turn his wealth into gold and take it with him into the country. It is consequently true that the poorest and most inexperienced rancher in New Mexico today finds it easier to invest his money safely and profitably than a conspicuously successful business man familiar with the international center of trade and commerce could only two hundred years ago. Naturally, no small part of this amazing transformation has been directly due to the development of organized securities markets.

The Stock Exchange is naturally of increasing value and significance to the investor in proportion to the sums of money which he has to invest. To the man of wealth the Exchange is as much a part of the daily machinery of business life as the bank or the stock corporation. While he gets no greater concessions made to him on the Exchange than the small investor, still the Exchange is to him a protector and a safe-

guard, since it enables him to shift his investments to suit his needs or sell them quickly in case of necessity.

### **Services of the Stock Exchange to the Manufacturer.—**

Turning next to the manufacturer, we have seen that economic forces have favored the creation of large-scale corporations in the industrial world,<sup>13</sup> and that the Stock Exchange provides an indispensable machinery for the gradual distribution of their securities among investors.<sup>14</sup> Without a Stock Exchange which makes it possible for speculators to carry the "floating supply" of a particular stock and thus largely segregate and stabilize the risks of industry as they exert themselves upon it, the manufacturer himself would have to sustain the risk of his company entirely alone, and probably have to go into the security business himself. In the swift and continual expansion of American productive facilities to supply a steadily growing demand, there is a constant tendency for manufacturing and commercial firms to expand their small and closely owned companies into large stock corporations with a greatly augmented industrial equipment and output. This healthy and desirable development of American manufacturing and commercial firms calls for additional capital, which is mainly obtained by the distribution of the expanding company's stocks and bonds to the speculating and investing public through the free and open market provided by the stock exchanges.

In recent years the experience of our manufacturers in this respect is only a vivid and contemporary instance of the long-established fact that the creation and operation of large units of industry invariably necessitates the stock corporation with its thousands of stockholding partners, and the stock exchange where its stocks—which are only the certificates of such partnerships—can be readily bought and sold. Upon the ability of the stock exchanges—and in this country, particularly upon the New York Stock Exchange—to render stocks and bonds im-

<sup>13</sup> See Chapter I, p. 15.

<sup>14</sup> See Chapter IV, p. 108.



mediately marketable, has long depended and will always depend, the rate of progress and growth in American industry.

To the fact that the New York money market facilities for carrying unsold securities have long been superior to those of any other money market in the world, can be very largely attributed the vast and healthy growth of industry in this as compared with other countries.

American business corporations have recently been indebted to the Stock Exchange for two other services of great importance. Through financing with rights, they have been able to raise hundreds of millions of dollars by the sale of additional shares through the stock market; this fresh capital has been variously employed to retire bond issues or commercial indebtedness and strengthen their capital structure, to acquire extensive foreign and domestic assets, to install superior equipment, and to provide themselves with ample working capital and large cash assets. But in their new capacity of financial creditors, the Stock Exchange has through its call loan market enabled them to invest cash surpluses safely and productively; such loans "by other lenders" in 1929 aggregated \$3,000,000,000 all told.<sup>15</sup> Since the panic of 1929, these new tendencies in American finance have been subjected to severe criticism, some of which is undoubtedly justified. Yet this should not lead us to overlook the very sound and constructive results which have also flowed from them.

**The Stock Exchange and Modern Banking.**—Almost all bankers are in one way or another investors or dealers in securities, and in consequence almost every variety of bank depends in considerable measure upon the operation of the Stock Exchange. This fact was realized by the bankers themselves with particular force during the critical autumn of 1914, when the Exchange was compelled to keep its doors closed for several months.

The precise contact of the given banker with the Exchange depends, of course, upon the particular type of banking in

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<sup>15</sup> See Chapter XI, p. 283.

which he is engaged. We have seen that the savings bank is interested in securities as an investor. The investment banker, on the other hand, is chiefly an underwriter and dealer in securities.<sup>16</sup> Without a central organized market through which to distribute the larger new issues and render the larger old issues always negotiable, his business would revert rapidly to conditions prevailing in the security market a century ago. The commercial bank also has a contact of its own with the Exchange. For one thing, it usually holds listed bonds as a considerable part of its surplus. For another, it often makes both time and call loans on security collateral.

The economic function of such loans as well as their advantage to the commercial banker has been touched upon in previous chapters.<sup>17</sup> Nor is this mutually beneficial connection between commercial banking and the Stock Exchange confined simply to the large banks and financial institutions of Wall Street. The so-called "out-of-town banks"—an elastic New York expression which covers anything from the great banks of Boston, Chicago, or Philadelphia to thousands of small banks in all parts of the nation—also are interested in and to a degree dependent upon the Stock Exchange, if not directly, then by proxy,<sup>18</sup> since they are accustomed to loan part of their surplus funds on security collateral.

There is consequently a close and necessary connection between banks and stock exchanges, and the fact that in every financial center in the world the former cluster about the latter arises from this inevitable link, and their common interest from the inherent nature of their kindred business in credit instruments of one sort or another. Banking would be vastly more hazardous without a Stock Exchange, while the Exchange could not accomplish its vital work of rendering its listings always negotiable without the employment of credit extended by bankers.

Finally, many of our banks owe to the Stock Exchange a

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<sup>16</sup> See Chapter IV, p. 87.

<sup>17</sup> See Chapter IV, p. 107, and Chapter XI, p. 301.

<sup>18</sup> See Chapter XI, p. 283.

debt, partially historic and partly current, for its services in distributing their own bank stocks and rendering them, like other corporate securities, readily purchasable and salable.

**Services to the Organized Commodity Markets.**—Still another class of business institutions to which the New York Stock Exchange is of no small benefit includes the other organized markets of the country, not only the great commodity exchanges but also the smaller stock exchanges in various parts of the country. Many members of the national New York Stock Exchange are also members of the comparatively local stock exchanges of Boston, Chicago, Philadelphia, and other American cities,<sup>19</sup> and are often able to extend credit to purchasers of local securities listed there by hypothecating at the banks securities listed on the New York Stock Exchange. The same advantage also exists in the case of firms which are members of the New York Stock Exchange and also of the Chicago Board of Trade, the New York Cotton Exchange, and other commodity exchanges. During past periods of liquidation or credit shortage many a purchase of cotton or wheat made on credit has depended upon collateral loans obtained on securities listed on the Exchange. In this indirect but significant way the Stock Exchange, by keeping its many billion dollars' worth of listed securities readily negotiable, is a bulwark of strength to the conditions of credit which underlie the business of the entire nation.

**The Value of Stock Exchanges to Modern Government.**—Finally, organized security markets are essential today to the operation of our machinery of government. We so often forget that governments have in the long run, like corporations or individuals, to strike a balance between expenditure and income, and to make the amount of the one dependent upon the actual or potential amount of the other. The proudest government that ever existed cannot flout the immutable and eternal laws of economics and continue to exist. To only a limited

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<sup>19</sup> See Chapter XV, p. 435, and Appendix IVc.

extent, therefore, can a government stamp off fiat currency or bonds—beyond this point lies only economic chaos, social disruption, and the disintegration of government.<sup>20</sup>

Many sincere citizens of this and other countries have always had and perhaps will always have the curious idea that in these matters there is no limit to the powers of government, and that by some magical process government officials can indefinitely increase currency or issue any amount of its debt obligations simply by printing them, without regard for such dull and meaningless details as gold redemption, sinking fund requirements, or debt service charges. The many extraordinary economic diseases which arose after the war among many European governments—diseases which were largely due to this childlike faith in the unlimited power of governments to disregard the immutable principles both of economics and of common sense—have provided a wealth of laboratory material for scientific economists.

**Marketing the Public Debt.**—It is, of course, no detriment for a nation to remain moderately in debt year after year—on the contrary such a practice, if sanely limited, has certain salutary results. It was not, however, until the late seventeenth century that statesmen discovered this fact, and also the practical methods whereby this debt could be made interest-bearing, split up into small amounts represented by government bonds, and sold to individual investors. Since that time, however, this practice has been resorted to by practically all civilized governments. As an inevitable result, organized security markets have sprung up all over the world where these evidences of the government debt could be bought and sold, and thus given the negotiability and reliable public quotation essential to the best investments. The chief reason responsible for the creation of almost every great stock exchange in the world, in the first instance at least, was to assist the government in maintaining its credit and the negotiability of its debt. In the case

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<sup>20</sup> See Chapter I, p. 3.

of our own nation, a former chapter<sup>21</sup> has already described how the issuance of the original 6% bonds of the United States Government was primarily responsible for the first gathering of the earliest Wall Street stock-brokers under the buttonwood tree.

**Furnishing the Sinews of War.**—A study of the listings of the New York Stock Exchange during the past century reveals many instances when the latter institution extended no small assistance to the United States Government by providing a ready market for the purchase and sale of its interest-bearing debt. Following the 6% loan into which the debt incurred during the American Revolution was funded, new forms of the government debt found their dominant market on the Exchange during the Civil and Spanish wars. Still more recently, the huge Liberty Loan issues were and are being distributed there.<sup>22</sup> In the successful initial marketing of these issues the Exchange can also take a pardonable pride, since many of the more technical features of the task were accomplished through its cooperation.

The government is, of course, dependent for its income upon taxation, which in turn depends upon the contemporary condition of business. Since the Exchange serves as an indirect but powerful stabilizing force in American credit conditions, it very generally assists in making it easier to levy and collect taxes. During the period of severe war taxation how often has the individual or the corporation been able to obtain cash to pay its taxes only by liquidating its security investments on the Exchange! The Exchange serves to give American property that convertibility into cash and that value as collateral which are so vital to the necessities of government as well as of business. In addition to these services, past and present, which the Stock Exchange has rendered the Federal government, it has performed a similar service for many states, counties, and municipalities.

<sup>21</sup> See Chapter III, p. 62.

<sup>22</sup> See Chapter IV, p. 96, and Chapter X, p. 267.



**Organized Markets and the Consumer.**—But before concluding the present sketch of the benefits conferred by the stock exchanges upon American business and society, not simply the services which they have rendered to producers, but also those to consumers, must be considered. For the general consumer, whether he be a bank president or a bootblack, also has a vital interest in the successful operation of the stock exchanges, along with the banks and other essential parts of the modern machinery of credit.

It is well known that low costs for goods in America and elsewhere too, have been obtained through processes of wholesale production in quantity. But the gradual rise in the standards of living has only too often been attributed by academic writers simply and solely to new mechanical inventions and more efficient methods of production. In reality these elements, vital though they be, are only a part of the story. For in order to attain wholesale production of any commodity or article, large amounts of capital and large corporate industrial units are necessary, as well as the ability to distribute wholesale. The indispensable services to industry rendered by the Stock Exchange in enabling large-scale capital to be accumulated through the sale of corporate stocks and bonds has already been noted. Moreover, with respect to the present-day methods of wholesale distribution, the ability of organized markets to facilitate wholesale production is significant. To all these factors, therefore, must be attributed the gradual cheapening of goods and services in terms of wages and salaries, and the consequent rise in the standard of living.

**Consumption the Test of Civilization.**—The vital economic benefit to the public at large of the present-day machinery of capital and credit (of which stock exchanges are an integral and essential part) can better be realized when it is remembered that, in the last analysis, the real purpose of all our modern machinery of both production and distribution—of all our mills, factories, railroads, warehouses and shops,

banks, and stock exchanges—is to feed, clothe, and shelter the world's present and prospective inhabitants, and provide them with the commodities, services, and manufactured articles necessary and desirable to their daily existence.

**Growth of Population Under Capitalism and Socialism.**

—The rapid increase in population both in this country and abroad has been in a great measure due to the effectiveness of our financial machinery over the past century and a half. This swift growth in the population of civilized countries is, moreover, peculiar to the present-day so-called "capitalistic" era of history. In the Middle Ages, and even during the earlier portion of the Renaissance period, the population of Europe was largely stationary, for the quantity production of goods was then prevented by the lack of scientific and mechanical knowledge, uneconomic legislation, and the inability to finance or distribute mass output. Since, therefore, the commodities and goods necessary to human existence were produced in a relatively fixed volume, only a fixed number of human beings were permitted to find shelter, clothing, and food. Children born over and above a fixed rate therefore perished from the lack of these essentials to life. If, under this mediæval system of fixed production, speculation and usury were largely held in abeyance, it is nevertheless true that the continual economic slaughter of human beings was necessary to its maintenance. An interesting modern analogy to this grim and (to us) inhuman condition of affairs is furnished by Bolshevist Russia, where the population has had to adjust itself to meet the limited output of goods and foodstuffs permitted by the socialist theory of producing without the speculative carrying of surplus, and other functions performed by the modern machinery of capital.

**The Instance of Great Britain.**—Despite the clamor of the agitator and the economic crank, the "capitalistic order," as they call it, has had a very different record. By the invention of mechanical labor-saving devices and the credit machinery needed to install and operate these devices, a vast energy and

flexibility was imparted to the production and distribution of goods. At once more goods became available for human consumption, the individual struggle for existence became easier, and the populations of the civilized nations began to grow. A well-known economic authority<sup>23</sup> has stated that during the single century from 1651 to 1751, when the first real indications of the coming capitalistic era were manifested, the population of Great Britain increased from 6,378,000 to 7,392,000. But during the next century (1751-1851), which witnessed the establishment of steam production, steam distribution, modern banking, and the London Stock Exchange, the population shot upward to 21,185,000, an increase of 13,793,000. Even more astonishing was the increase in population during the next sixty years (1851-1911), by 19,350,000 to a total in 1911 of 40,535,000. Nor do these figures reflect the huge emigration of Englishmen to all parts of the world, which occurred during the same periods. As Hartley Withers has so well remarked: <sup>24</sup>

Merely to enable so large a number of people to be alive is not everything, but it is a great deal. Under Capitalism, all these millions saw the light of the sun, smelt the scent of spring, knew love and friendship, made and laughed at good and bad jokes, ate and digested their meals, made their queer guesses at the secret of life, played games, read books, cherished their hobbies and their prejudices, knew a little, thought they knew much more, and went their way leaving others behind them to take up the thread of life and spin another strip of its mysterious cloth. . . . If life is a good thing—and most of us waste little time in sending for a doctor if we do not feel well—Capitalism has made the enjoyment of that good possible to millions.

Owing to the constant stream of immigration into this country, figures for the growth of population in the United States are not so conclusive. Yet it is undoubtedly true that under any system where a surplus of goods and securities could not be speculatively carried and distributed, our country could not possibly have attained its present great population, nor

<sup>23</sup> Dr. Shadwell, "The History of Industrialism," in the *Encyclopedia of Industrialism*.

<sup>24</sup> Hartley Withers, "The Case for Capitalism," p. 116.

could it have developed either a city or rural life at all comparable to modern conditions in town and country. Thus, many of the agitators who declaim loudest against the present economic scheme of things could not have long drawn the breath of life in this world, had their birth and upbringing occurred under those very economic conditions of which they are the incessant advocates.

**The Rising Standard of Living.**—But there is another side to this profound service rendered to the average human being by scientific invention, quantity production, speculative distribution, and the modern machinery of credit in which the Stock Exchange is so integral a factor. Not only can more people live under these conditions, but the standards of living of the average human being have been vastly improved by the flood of goods produced by capitalism. Not only the necessities of life, but comforts and luxuries of whose very existence the most wealthy and powerful men in the past never dreamed, have through our factories, our banks, and our stock exchanges, been placed within the reach of practically everyone. In order to get a more vivid and accurate sense of the significance of this economic tendency, it may not be out of place here to note briefly certain differences between the daily life of a mediæval baron on the one hand, and that of a very plain modern citizen—say a haberdasher's clerk—on the other.

The baron, for all his jewels, wore coarse hand-made clothes dyed roughly and in few colors. His palace knew no light except candles and torches and no heat except that of open log fires. His food was extremely monotonous, and all the long winter consisted mainly of salted fish and salted meat, with no vegetables or fruit. Hence, contemporary poets hailed "the sweet spring" with no little enthusiasm. Sugar was a rare oriental luxury; tea and coffee were unknown. Even the commonest spices were distinct luxuries and were laboriously brought into Europe by caravan from Asia and sold at extraordinary prices.

**Life in the Middle Ages.**—The Baron bathed rarely and without soap. Even as late as the days of “good Queen Bess” it was deemed advisable when presenting a masque to the noble ladies and gentlemen at court, to have a perfumer walk up and down through the audience, lest the odor of the unwashed flower of England’s lords and ladies overcome the pleasant fancies of the dramatist. Glass windows were unknown in the castles of the Middle Ages, and the dark castle halls were hung with flapping arras behind which the assassin often lurked. Carpets were luxuries and had to be imported from the East; among the rotting rushes which covered the floors, dogs growled over half-consumed bits of food cast to them from their master’s table. Owing largely to the prevailing ideas of a “fair price” and the punishment prescribed for charging interest or speculating, starvation among the common people was common and hunger among the nobility not unknown.

There were no sewers, no drains, no medicines except the superstitious concoctions of the age, no surgical instruments except the axe and the dagger. A constant menace from plague and disease shadowed lord and vassal without partiality. Pigs were depended upon to clear the narrow city streets of refuse, and also to feed the inhabitants. When the baron traveled, he went on horseback and in armor which, if like Banquo he rode unattended at night, did not always save him from being murdered. His wealth consisted mainly of real estate, his income of rents paid in kind—a pig here, a bushel of wheat there—and his daily work of fighting his tenants to collect the one and his enemies in protecting the other. His only entertainment, apart from these not altogether pleasurable diversions, was furnished by wandering jugglers, the songs of the occasional minstrel, or the reiterated jests of a court fool. Such an existence, romantically as it has been described by Sir Walter Scott, scarcely appeals in a practical way to the modern American. And yet the baron was the



dominant social, political, and economic figure of his age. The daily life of the common man in the Middle Ages can best be left to the imagination.

**Standards of Modern Consumer.**—And now for our haberdasher's clerk. He dresses in a variety of plain but substantial clothing, and for breakfast, if he is especially hungry, has the choice of imported fruits (be it January or June), coffee from Java or Brazil, eggs from ten to a thousand miles away, fresh milk, white bread, and cereals from wheat grown in Canada or the Dakotas, with pepper from the East Indies and sugar from Cuba included as a matter of course. He rides to work in a trolley, subway, or steam railroad car, a distance of several miles, or perhaps he makes the trip by auto bus. He lunches modestly, perhaps, but according to his fancy. And when the day's work is done he puffs contemplatively on a cigar assembled from Sumatra, Virginia, and Maryland, and summoning his friends by telephone, enjoys the most or least classic music on his phonograph or radio, or sallies forth to attend the motion pictures. He lives a longer, more pleasant, and more intelligent life, despite his modest income and subordinate economic position, than the average mediæval baron could picture in his wildest dreams.

The writer by no means wishes to imply that all this vast and tremendous economic transformation which the world has experienced in the past few centuries has been due simply to the creation of stock exchanges. Thousands of inventors, genuine statesmen and political reformers, scientists, pioneers, and adventurers have been necessary to obtain the degree of civilization which the average American enjoys today. Nevertheless, in every detail of the clerk's life described above the Stock Exchange as a source of corporate working capital has given a vast and often unrecognized cooperation in producing and making available for everyone's consumption those articles which in our own luxurious times have come to be considered as necessities.

As the clerk lives through what may seem to him a monotonous day, he nevertheless unconsciously depends upon corporations producing textiles and textile machinery, dyes, ships and foreign trade, railroad service, refined sugar, several varieties of electric transportation service, automobiles, tires, petroleum, tobacco, telephone service, phonographs, and the "silent drama," besides hundreds of other basic products like steel, copper, and coal. If the work done during the past century by the New York Stock Exchange for all these corporations could suddenly be subtracted from the present accumulated results of civilization, the indirect but very real link between the clerk's standard of living and the Exchange would not long seem so fanciful as it is otherwise apt to.

**Future Tasks of the Securities Market.**—Apart from its services as a support and stabilizer of business, the Stock Exchange may not inaptly be compared to the driving wheel of our modern economic structure as it is at present constituted. Its past and present services to society at large require not so much argument and contention as simply a true understanding. What its future services will consist of in detail no man can foresee. But certainly vast enterprises remain yet to be undertaken by the modern stock corporation to which, particularly in its initial and adventurous stage, the Exchange can give huge assistance. In the years to come our present means of communication may with its cooperation undergo further improvements. The wireless motion picture, the aeroplane, and many other inventions still await that commercializing process in which the Exchange must play its vital part before they can become conveniences of our everyday life. In addition, there are the countless inventions of the future whose very character we cannot today foresee. All such future corporate undertakings will call first upon the daring of the stock speculator before they can offer new services to mankind or new investments to the investor. As in our past so also in our future, the industrial and commercial progress of this nation is conse-

quently largely in the hands of her stock speculators, who will bear as stockholders the unavoidable risks of this progress. And in providing a market place where this necessary and vital work can be carried on, the Stock Exchange is destined to play an increasingly significant part in the basic and fundamental economic development of the United States.

The more complete and dispassionate understanding of the machinery of industry, trade, and finance, which year by year the American public is obtaining, is already effecting a far-reaching change in public sentiment regarding the Stock Exchange. With this fuller understanding the American public is ceasing to listen to the Siren songs of the self-seeking demagogue, or to look with prejudice and suspicion upon its principal securities market. Instead, the American people are coming to have in regard to the Stock Exchange, the same legitimate touch of national pride that it feels for other swiftly created, yet great and efficient, American business organizations and institutions which the historian of the future will inevitably consider as monuments to the daring, enterprise, and progress of our race.

## CHAPTER XVIII

### THE STOCK EXCHANGE AS AN INTERNATIONAL MARKET

**The International Traffic in Securities.**—At first glance it may seem a far cry indeed from the clamorous floor of the New York Stock Exchange to the distant capitals of Europe, Asia, and South America. Indeed, many American business men might greet with incredulity the statement that the banks, warehouses, shops, and factories of these far-away communities have a considerable stake in the swift making of security contracts which takes place about its posts or in its bond crowd. Nevertheless, even a brief examination into the actual structure of international trade reveals an intimate though often unrecognized relationship between the great New York security market and the foreign demand for American goods, the great ships which steam slowly out of our Atlantic and Pacific harbors each day laden with these goods, and American manufacturers who produce them in all parts of our country. So it is, too, with our farmers, lumberjacks, miners, and other producers of American raw materials. Year in and year out, and usually without their knowledge, the New York Stock Exchange extends no slight assistance to them in the sale of their products overseas. But before we can come to a right understanding of these international functions of the Exchange we must examine the complicated and little understood traffic in securities which occurs between different and frequently far distant stock exchanges.

**Communication Between Markets by Arbitrage.**—A former chapter has cited the inherent tendencies of markets to develop closer intercommunication and finally centralization in

single great markets.<sup>1</sup> These immemorial tendencies of trade specifically exert themselves through arbitrage between markets. Arbitrage may be defined as a special species of speculation based on intervals of space rather than intervals of time, and involving purchases and sales in different markets at the same time rather than in the same market at different times. If, for example, a given security is selling at 90 in one market and at 91 in another, there will always exist an opportunity simultaneously to buy in the former, sell in the latter, and profit by the difference in prices. Two factors are, of course, necessary in such arbitrage dealings—dependable markets and ready communications. The effect of arbitrage is naturally to keep prices on two different markets in close accord.

The technique of arbitrage between the old stock exchanges of Europe had been highly developed long before the nineteenth century. Also, the establishment of stock exchanges in New York, Philadelphia, Boston, and other American cities occurred early in the nineteenth century, and soon led to domestic arbitrage here. At first arbitrage was everywhere risky and intermittent, since it had to depend upon communication by stage coaches and carrier pigeons. The invention of the telegraph, by shortening the practical time interval between markets, increased and refined arbitrage here and abroad. Within the United States, therefore, arbitrage of one sort or another in securities listed on different American stock exchanges has long occurred, although domestic arbitrage based upon continuous quotations from the floor of the New York Stock Exchange is now forbidden. More and more, however, there has been a tendency in America for the principal market in our leading securities to gravitate to New York, and owing to the particularly efficient wire and quotation systems of the New York Stock Exchange, its market has been placed effectually at the service of people in practically all parts of this country.

But arbitrage across the Atlantic Ocean, involving as it did more serious delays in communication, was naturally slower in

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<sup>1</sup> See Chapter II, p. 39.



developing a continuous character and a highly perfected technique. The need for it existed long before the ability to accomplish it efficiently. During the nineteenth century the United States was continually a debtor nation, and to build up rapidly our railway, mining, and industrial corporations it was therefore necessary to borrow capital heavily in Europe. For many decades, in fact, American economic development was largely limited by the degree of enthusiasm exhibited for these enterprises by European security investors. As a result, very few foreign securities were listed or dealt in upon the New York Stock Exchange, while very large dealings in our securities became in time a regular occurrence on the stock exchanges of London, Amsterdam, and other European centers. The American issues, which thus came to possess regular stock exchange markets in Europe as well as in New York, were often called "international securities." London particularly, as the unquestioned financial center of the world, actively invested and traded even from the early decades of the nineteenth century in "Yankee rails" and other American company and even government securities, whose turnover there constituted a large proportion of the total dealings on the great London Stock Exchange.

In the beginning, prices for the same American security in New York and London varied considerably and were established principally by local conditions, since the old packet ships took weeks to cross the Atlantic. In consequence, trans-Atlantic arbitrage at first was slow, risky, and of minor importance. At mid-century, the new invention of steam navigation, by improving trans-Atlantic communication, tended to expand arbitrage between New York and London and magnify its importance in the stock exchanges of both centers. But after 1886, the opening of the trans-Atlantic cables reduced communication across the Atlantic from a matter of days to one of seconds, and with this vastly more efficient facility, arbitrage in American securities between London and New York greatly

expanded in scope, perfection of technique, and economic significance both here and abroad.

By reason of this development in arbitrage, domestic and foreign prices for American "international" securities were kept much closer together than ever before, and these issues enjoyed a much broader market; for when New York would not buy, London and other foreign centers would, and vice versa. On the other hand, American economic conditions came to play a much more immediate and important part in the foreign markets, and foreign conditions in our markets. If our Spanish War shook the British markets, so their Boer War shook ours. But the effect of this closer community of interest between security markets was on the whole highly beneficial, since it facilitated a vast flow of European capital into our gigantic railway and other business projects.

International arbitrage, of course, involves a thorough knowledge of foreign stock market practices. Foreign systems of price quotation are sometimes on a very different basis than our own; in London, for example, bonds are usually quoted "flat," but in New York usually "with interest."<sup>2</sup> Also, contrasting with our cash settlement, foreign stock exchanges sometimes employ a fortnightly term settlement. When it was necessary to ship certificates from abroad to deliver in New York, usually the sales on the New York Stock Exchange were made for delivery by the seller at his option any time within 30 days ("seller 30" in the jargon of Wall Street), instead of being made "regular way" for delivery the next full business day. Arbitrage transactions, like other speculative dealings, involve the assumption of risks for possible private profits. So keen is the competition between arbitrageurs here and abroad, that prices are kept close together, and normally arbitrage profits are small indeed in comparison with the trained skill, extensive facilities, and capital risks which they require

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<sup>2</sup> See Chapter X, p. 268.

Speaking of the difficulties of the arbitrage business, a former governor of the Exchange stated:

Because of its complexity and its risks, arbitraging is not a business that appeals to beginners on the floor. One must have reliable colleagues on the foreign Exchanges who are constantly watchful and alert, and who are moreover possessed of sufficient capital to finance large transactions. In addition, there are labyrinthine difficulties to surmount in the way of commissions, interest charges, insurance of securities in transit, fluctuations in the money markets abroad and at home, cable tolls, letters of confirmation, rates of foreign exchange, settlement days, contangoes and many other matters. Unless a man has had a long experience in the difficult art of arbitraging, he had better shun it or prepare for trouble.<sup>3</sup>

Into these and other subtleties and technicalities it is not particularly to our present purpose to inquire. It is sufficient to have instanced the basic principles upon which arbitrage operations rest.

**Former Arbitrage on the Floor.**—Formerly this arbitrage business between New York and foreign centers had its appropriate machinery on the Stock Exchange floor. Against the south wall of the board room was the "arbitrage rail," behind which were pneumatic tubes connecting the floor with the cable offices in the basement of the building. As an added convenience, most of the so-called "international stocks" were located at the row of stock posts nearest the rail. By posting themselves near this rail, therefore, the members of the Exchange who did an arbitrage business could receive and deliver messages and orders from and to the foreign stock exchanges with astonishing speed. According to the same authority cited above,<sup>4</sup> "the arbitrageur may buy in New York and sell in London and receive a confirmation, all in three minutes."

Few features of Wall Street life so irresistibly appeal to the imagination as this extraordinary business, conducted in the various world markets over the flashing cables with a speed vastly more rapid than the roll of the earth from darkness into

<sup>3</sup> Van Antwerp, p. 284.

<sup>4</sup> *Ibid.*, p. 284.

darkness. By such means the New York and London markets particularly were normally kept in the closest touch with each other.

**Dealings Between New York and London.**—New York time, however, is later than London time by five hours less four minutes and one second. Thus, when the Stock Exchange of London opens, it is long before the 10 o'clock opening of the New York Stock Exchange, which occurs at 2:56 P.M. London time. Although the Stock Exchange in London closed at 3 P.M. (London time), its market in "Yankee rails" continued outside the Exchange till the 3 o'clock closing of the New York Stock Exchange, which occurred at 7:56 P.M. in London. In consequence, 2 o'clock London quotations in American issues used to reach Wall Street brokerage offices about 9:20 A.M. (New York time), and gave the earliest lead here as to the likely trend of prices on the New York Stock Exchange that day. Sometimes, however, the price trend in London was not followed in New York.

London quotations required skilled interpretation, since the London stock ticker recorded only bids and offers but no prices, and never the number of shares sold.<sup>5</sup> Also, for convenience in dealing, the pound sterling was for quotation purposes always taken at \$5.00, and the difference between this figure and the actual current exchange rate was adjusted in the London price quotation. Thus, with exchange at—say—\$4.87½ to the pound, a stock quoted at 50 in London would be quoted 48¾ here, and so on.

**Changes in the Arbitrage System.**—The old business of arbitraging from the floor of the New York Stock Exchange caused constant infringements upon its commission law,<sup>6</sup> since as a rule it was carried on "joint account" between a New York Stock Exchange member here and some non-member of this Exchange abroad, with the result that the Exchange mem-

<sup>5</sup> See Appendix XVIIIa.

<sup>6</sup> See Chapter XVI, p. 456.

ber here actually received less than the required minimum commission. By a resolution of the Governing Committee in 1911, such joint accounts were forbidden.

The coming of war conditions effectually changed the whole basis of the business. Severe laws were enacted abroad forbidding the import of securities there because of the consequent export of capital which it caused. Term trading was likewise suspended for several years on the British and continental stock exchanges.<sup>7</sup> The cables were heavily burdened and under rigid censorship. Also, during the war period the great bulk of American securities held abroad was sold back to Americans through the New York market. Thus, not until two years after the Armistice were conditions suitable to justify an attempt to revive the pre-war methods of normal and efficient arbitrage between New York and foreign centers. In 1920 the Governing Committee rescinded the resolution of 1911, but placed certain restrictions upon joint account arbitrage designed to rid it of its objectionable features.<sup>8</sup> By the terms of these restrictions, the old system of the "arbitrage rail" was not reestablished, and thereafter arbitrage transactions, if conducted by New York Stock Exchange members, have been centered in their offices rather than in the Board room. Former arbitrage in American securities has only partially revived because of the comparative lack of these issues now abroad, and consequently the lack of extensive markets for them there. On the other hand, as foreign securities are listed on the New York Stock Exchange, arbitrage in them—a relatively new species of Wall Street business—has developed.

**Benefit of a Broader Market.**—The fact that American securities were listed and traded in abroad as well as in New York made a broader market for them, and tended to make them easier to buy and sell, and at fairer prices.<sup>9</sup> We have seen that similar results were obtained for the Stock Exchange

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<sup>7</sup> See Chapter XI, p. 308.

<sup>8</sup> Constitution, Chapter X.

<sup>9</sup> See Chapter II, p. 45.



by the extension of its members' branch offices all over the country.<sup>10</sup> One great factor tending toward the elimination of the manipulation of prices was provided by the opposition on foreign stock exchanges to it, transmitted to the New York market by arbitrageurs. This all comes back to the fact previously mentioned,<sup>11</sup> that the bigger and broader a market is, the more difficult it is for anyone to distort its prices even temporarily by manipulative tactics.

**Securities as a Medium of International Exchange.**—But perhaps most important of all, this close connection between the New York and European securities exchanges made international securities, owing to their instant negotiability here and abroad, practically a medium of exchange like gold or bank credit.<sup>12</sup> As one well-known authority on finance and economics<sup>13</sup> has put it:

Securities form one of the greatest and the most important parts of the modern mechanism of exchange. They are, in many cases, as good as money, and in some cases are better than money. If a large shipment of money has to be made from New York to London, it is much more economical to ship securities of the same amount than to ship kegs of gold.

This essential though little realized fact, that the international securities on the stock exchanges afford an acceptable substitute for gold as a medium of payment between nations, is of enormous importance with respect to America's whole foreign trade. It therefore deserves detailed explanation here, even though such an explanation lead us into the thorny and seemingly irrelevant jungle of foreign exchange, visible and invisible trade balances, and kindred topics.

**Composition of the International Balance of Trade.**—To understand the fundamental principles governing international trade, we must rid ourselves of the short-sighted but prevalent

<sup>10</sup> See Chapter XV, p. 409.

<sup>11</sup> See Chapter IV, p. 103.

<sup>12</sup> See Appendix XVIIIb.

<sup>13</sup> Charles A. Conant, "Wall Street and the Country."

notion that only physical goods are bought and sold among nations. To be true, our monthly government reports of the foreign exports and imports of the United States include only the physical merchandise and raw materials which are loaded or unloaded as ship cargoes, and which pass inspection of our customs officials at our various ports. This part of our total sales to and purchases from foreign countries is known as our "visible" trade, and the statistics upon it have long been collected by our various customs houses and consolidated in the monthly foreign trade report of United States exports and imports issued by the Department of Commerce in Washington.

**The "Invisible Trade."**—Yet this buying and selling of physical (and therefore "visible") goods between nations constitutes only a portion, albeit the largest and most fundamental one, of our total international traffic. For as a nation, we also are buyers and sellers in the "invisible" trade in what, for want of a better term, are known as "services." This elastic term of "services" covers a multitude of different transactions. If an American exporting firm hires a British vessel or a Canadian railroad to carry its goods into Great Britain or Canada, it is importing transportation service. If either cargo is insured in the course of transit by a foreign insurance company, this service too constitutes an American import. When a foreign immigrant here sends money back to the "old country," America may likewise be said, in the economic sense, to be importing the service of his hands and brains from the country whither his funds are sent. When furthermore, the American ventures abroad, whether to study in the Sorbonne, to admire cathedral towns, or simply to enjoy a vacation in any foreign country, the grim laws of economics score his expenditures down as another American import—whether of learning, artistic appreciation, or mere pleasure. Gold is also, of course, bought and sold between nations, and is naturally a visible import or export. Because of its special

significance to currencies and credits, however, the yellow metal is not included in the ordinary tale of visible imports or exports along with such less romantic goods as soft coal, machinery, or wheat, but separate statistics are kept of its "arrivals" and "departures" to and from our ports. The same practice is also followed in the case of silver—the other financial metal.

And so this list might be enumerated, to include the thousand-and-one different cases where an international bargain of some kind has been struck. Two other classes of services, however, are of sufficient importance to deserve consideration here—bank credit and securities.<sup>14</sup> Just as securities can be shifted from one country to another through stock exchanges, so bank credit can be exported and imported by steamer or even by cable. Both must therefore be included as a final but important item in the total exports and imports of any nation. Thus, when a German sells his bonds or stocks to an American, America may in consequence be said to export its capital to Germany, and we in turn import the receipt for this exported capital of ours in the form of German stock or bond certificates. So, too, bank credit can be shifted between nations by international banking operations.

**The Actual Balance of Trade.**—But one feature of all this bewildering purchase and sale of goods and services carried on by every modern nation should be clearly noted. In the long run the total exports of every nation must balance its total imports. No nation can regularly and indefinitely buy more than it sells, or sell more than it buys, from or to the rest of the world. This fact may seem in direct contradiction to the facts presented by our past pre-war foreign trade reports. Even

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<sup>14</sup> In enumerating the various items which constitute a nation's invisible trade, an initial question of definition exists. Contrary to the prevailing custom, securities and bank capital in the last analysis should probably not be included in the so-called "international trade balances" at all, since they do not represent consumable goods or services, but rather income-bearing loans tendered as long- or short-term payments for past or future goods and services. Certainly, a nation is a debtor or creditor nation according to whether it imports or exports a balance of securities and bank credit. Yet, for the sake of simplicity and clarity, the author has deemed it advisable in the ensuing account of international trade and finance conventionally to include securities and bank credit as services in the invisible trade.

before the war, the United States regularly showed greater exports than imports in its trade returns, and many people, who gave the matter only a careless consideration, were wont to think that this country profited by the amount of our excess exports. Such a fallacious view, of course, left out of all reckoning our invisible trade, wherein we were steadily importing more services from other nations than we exported. Strictly speaking, then, there is normally no such thing as a permanent "favorable balance" in a nation's total foreign trade with the world. There may be a relatively permanent favorable balance in the visible or in the invisible trade, but total exports must in the long run balance total imports.

**How International Payments Come to Balance.**—At this point it may well be asked how it happens that every nation's total exports and total imports come to balance in this way. Trade is, after all, mainly free, and individuals in every country can usually buy and sell such goods or services from or to foreigners as they please. When the Chicago merchant buys French tapestries, or when the Detroit manufacturer sells an automobile to an Argentine or a Brazilian, neither has the slightest thought or anxiety as to the effect of his transactions upon our national trade balance. Indeed, relatively few people here or abroad even understand what national trade balances really are. Furthermore, most items in a nation's international trade are governed as to their amounts not only by free choice but also often by inevitable and quite inflexible circumstances. What, then, brings about this continual balance between each nation's total exports and total imports? The answer, of course, is—the flexible financial items in the total trade list, consisting of gold, bank credit, and securities.

Fundamentally, in every gold standard nation, the basic method of balancing its international trading account with the world consists in shipping or receiving gold. Such shifting of actual gold bullion can be effected fairly quickly, and no gold standard creditor can, of course, ordinarily refuse to

take payment in this form. Yet serious limitations are in practice placed upon the extent to which gold shipments can be employed to right trade balances. In the first place, the amount of gold in the world plus the likely future gold production today is small in proportion to the debits and credits contracted in terms of gold, and for this reason it is necessary either to restrain the growth of both international and domestic business, or to find substitutes for gold payments. Also, gold shipments are in practice attended by some delay, and considerable expense from cooperage, cartage, freight, insurance charges, and insurance in transit. Furthermore, since the currency and bank credit of the exporting and importing nations are normally based upon gold, any considerable gold shipments may result in financial deflation in the exporting country and financial inflation in the importing country. This explains the intense "news interest" and public attention which invariably attends gold shipments. These serious deterrents to gold shipments therefore render them a last resort in righting trade balances, and practically compel the resort to alternative methods where these are possible.

**International Shifting of Bank Credit.**—One common alternative to the use of gold shipments in righting international trade balances is, of course, the shifting of bank credit between nations. This can be done swiftly and inexpensively over the international cables, and it is daily resorted to between nations as a more efficient way not only of righting trade balances but of doing business at all.

This use of bank credit in international trade is centuries old, and has developed a very extensive and complex technique of its own. Not since the Middle Ages has it been always necessary in international business transactions to exchange the actual metal money of one country for that of another; instead, dealings in credit in terms of foreign currencies have developed in every important country. This credit usually takes the form of bankers' bills of exchange.



Between the currencies of two gold standard nations, the rate of exchange will, of course, depend upon the actual amount of gold in their respective standard gold coins. This ratio is called the "par of exchange." But when bank credit in terms of one coinage is exchanged for bank credit of a foreign coinage, these foreign exchange rates can and do fluctuate considerably.

**The Market for Foreign Exchange.**—The current rate of Exchange arises from the conditions of supply and demand attending the purchase and sale of bills which are drawn in foreign currencies to make payments for the international traffic in goods and services. When, for example, an American firm ships wheat to an English firm, it may obtain payment for the shipment by drawing a draft against the latter in pounds sterling and selling it, at the current rate of exchange, for American dollars. Similarly, if the American firm hires a British shipping company to transport the wheat to, say, Liverpool, the British company may elect to draw a dollar draft there against the American shipper and sell it, at the current rate for exchange, for pounds sterling. But while this is going on American buyers of English goods are seeking in New York, and British buyers of American goods are seeking in London, means of making their international payments. This they can do, with the assistance of a dealer in foreign exchange, by purchasing the drafts on the appropriate foreign country, which have been drawn by creditors of their own nationality, as shown above. For this reason there is a constant supply of and demand for sterling drafts in New York, and for dollar drafts in London. The rate of exchange between dollars and pounds depends upon this double supply and demand for bills drawn in the two foreign currencies in the two centers. If more sterling bills, for example, are offered than demanded in New York, the rate for sterling here tends to decline from the mint par rate of exchange between pounds and dollars, and, of course, dollars rise in proportion above the

mint par rate. Similarly, if more dollar drafts are demanded than offered in London, dollars will tend to buy more pounds and pounds fewer dollars so long as this condition remains. The same rate of exchange is maintained in both London and New York through constant arbitraging between the two centers by foreign exchange dealers all over the world.

In New York and London, rates of foreign exchange with the home currency are made and quoted individually by the leading banks and financial firms engaging extensively in this business. In Paris and Berlin official dealings and quotations in foreign exchange occur on the stock exchanges. Neither the London nor the New York Stock Exchange concern themselves with dealings in foreign exchange.<sup>15</sup>

In practice, the fluctuations in foreign exchange rates between two gold standard countries usually occur within the so-called "gold points," which are rates respectively above and below the par rate of exchange for the given foreign currency. The difference between the par rate of exchange and either gold point represents the cost of shipping gold between the two countries. For this reason, should British sterling drop below its lower "gold point" in terms of American dollars, it would at once become cheaper for the British to make payments in America by shipping gold thither rather than by purchasing American bank credit in the form of bills and drafts drawn in dollars at the unfavorable current exchange rate. Conversely, should British sterling rise above its upper "gold point" with American dollars, British credit in sterling would at once prove more expensive for Americans than gold shipments to Great Britain. When a nation is not upon the gold standard, no such gold points, of course, exist and its rate of exchange with foreign gold currencies may fluctuate wildly unless artificially "pegged" or stabilized in some way. These principles were strikingly illustrated by the experience of many European currencies during and after the World War.

Since all goods and services sold in foreign trade must be

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<sup>15</sup> See Appendix XVIIIc.

paid for, foreign exchange rates afford an interesting and often reliable index to the condition of a nation's foreign trade balances. When America sells more goods and services to the rest of the world than she buys from it, normally dollar exchange will tend to rise in foreign currencies, and foreign exchange rates decline in New York. Conversely, when we are selling to the world less than we are buying from it, dollar exchange will ordinarily tend to decline abroad and foreign exchange rates rise in New York.

Yet the shifting of short-term bank credit will often minimize or prevent such operations in the normal course of events. If, for example, British sterling exchange begins to decline in New York, speculators in foreign exchange may be tempted to use their dollars to purchase sterling short-term banking instruments in the hope of reselling them later when a higher sterling exchange rate prevails. Also, interest rates will often rise in a country whose currency is declining in the foreign exchange market, and this may persuade foreign capitalists and financial institutions to transfer their funds from the lower to the higher interest country. This is one reason why central banks tend to raise their discount rates when their home currency is declining in the foreign exchange markets, and lower them when it is rising.

Thus, owing to the supplies of liquid speculative capital in the leading financial centers, to changes in comparative interest rates in different nations, and sometimes to the conscious manipulative operations of the leading central banks of issue, considerable and frequent disparities in a nation's trade balance with the rest of the world can be offset by the shifting of bank credit, without resort to gold shipments.

The international shifting of bank credit to right a nation's unbalanced trade relations with other countries is therefore not only swift and efficient but indispensable in the modern world. Nor are its possibilities yet fully developed. The international reparations bank established by the Young plan will presumably fill a useful function in just this respect. Closer coopera-

tion between the leading central rediscount banks of the world has already shown a similar power.

Nevertheless, there are important limitations upon the employment of bank credit for such purposes. To begin with, it is of only temporary usefulness, for bank credit except in special circumstances cannot readily be tied up in large amounts and for long periods in foreign countries. Moreover, as in the case with international gold shipments, the extent to which bank credit can be employed internationally to balance trade accounts is limited. For if the banks of a given country should attempt to transfer their credit abroad in unlimited quantities, violent and convulsive movements in the home money markets would soon be produced, to the disadvantage of domestic business.<sup>16</sup>

**The International Shifting of Securities.**—In consequence, to avoid the harmful economic results of over-exporting or over-importing gold or bank credit to right national trade balances, the third expedient of shifting securities from one country to another must be constantly and extensively employed. As a result, the international shifting of securities contributes today in a very vital way toward the maintenance of balanced trade and exchange rates and the avoidance of excessive exports or imports of gold or bank credit; it likewise serves as a stabilizing force upon the production rate of goods and services, the buying power of currencies, and upon all the other items which enter into foreign trade accounts. The international shifting of securities occurs most readily, of course, in security issues listed upon both a domestic and a foreign stock exchange. It is, of course, true that securities not so listed are frequently shifted from one country to another, yet this process as a rule does not occur so readily. Thus it came about that in recent years no small part of the task of restoring the gold standard abroad really fell upon the New York Stock Exchange because of the important part

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<sup>16</sup> See Appendix XVIII.

this market regularly plays in our international traffic in securities.

**Automatic Character of International Adjustment.—**

Between gold standard countries, the adjustment of trade balances through the shifting of bank credit and securities, and to a lesser extent of gold, is practically automatic because of the effect of exchange rates and interest rates. If, for example, French franc exchange should decline in terms of dollars, bankers' bills or securities valued in terms of francs would become cheap to American purchasers, and induce additional purchases of both from New York. Similarly, when the New York money rates rise above those in France, there is at once an inducement to Frenchmen to invest in short dollar credits and in American securities if their price has declined under the influence of advancing domestic short-money rates.

For the same reason, debtor countries which chronically need credit and capital will normally have higher interest rates and security yields than creditor nations which have surplus credit and capital. This situation is apt to induce a flow of capital and credit from the low interest creditor countries into the bills and securities of the high interest debtor countries which may continue for long periods of time.

**The Pre-War American Trade Balance.—**Every nation, according to its age, temperament, situation, and resources, differs from every other nation in the respective proportions to which the many items in its visible and invisible trade enter into its total exports and total imports. For purposes of illustration, the foreign trade of this country as it existed prior to 1914 may be contrasted with that of Great Britain. We regularly exported more raw materials and manufactured goods than we imported. But our excess visible exports were balanced by our excess invisible imports. Despite our large foreign trade, the American flag was hardly ever seen prior to 1914 on the seven seas, and we were consequently forced to pay huge annual sums to British and other foreign shipping



companies in freight charges on our foreign trade. The insurance of these goods was carried mainly by foreign insurance companies, and this was another American invisible import. Our immigrants remitted huge sums each year to Europe, and our tourists abroad spent as much again. Moreover, as we have seen,<sup>17</sup> America was steadily importing capital by selling her securities abroad, and in addition was remitting vast sums annually in interest and dividends on our bonds and stocks held abroad. We were in consequence really a debtor nation then, and wise old Europe as she received dividends from us, and clipped coupons from American bonds, could well afford to agree with us when we told her how prosperous we were and how much money we were making.

**The International Trade Position of Great Britain.**—The situation in Great Britain, however, was just the reverse. The British regularly imported more goods than they exported—a fact which some unsophisticated critics thought alarming. But in the invisible trade Britain exported vastly more services than she imported. Hers was the greatest merchant marine on the seas, the vast insurance business centering at Lloyd's was internationally famous, and her preeminent banking center and stock market in London exported credit and capital to the far corners of the earth. So successful was Great Britain in her total foreign trade that she was able to import many millions in foreign securities each year in balancing her accounts with the world. The flood of dividends and bond interest which returned to London each year proclaimed her the world's greatest creditor nation.

**Epoch-Making Character of the Great War.**—The World War wrought vast and profound changes throughout the economic structure of the whole world, and particularly in international trade. Civilization was, in fact, shaken to its depths, and while the wreckage and waste caused by the war have

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<sup>17</sup> See Chapter III, p. 70.

now been largely repaired, the debts proceeding from it may not be liquidated for many years. While our capitalistic scheme of things has triumphantly survived this severest test ever made of its ability to endure, nevertheless profound economic changes have been produced by it practically everywhere. In few countries have these changes been more arresting than in the United States, and in few branches of American business more completely so than in American finance. It is today a futile dream to expect any return of pre-war conditions—for better or for worse the world in which we live has been permanently transformed by the war. If we are to understand our modern society, and particularly its capital markets, we cannot remain satisfied with descriptions, explanations or economic theories which originated before Sarajevo.

**The Stock Exchange at the Outbreak of War.**—When out of a clear sky the Great War burst upon Europe, America was still heavily a debtor nation. For over a century our surplus visible exports had balanced surplus invisible imports of foreign capital which had been used to build up this country. Europe, and particularly England, had accumulated billions of dollars' worth of our choicest securities, many of which were listed on the New York Stock Exchange. When the war came, the Berliner Borse practically suspended, and on July 31 the Stock Exchange of London, the Paris Bourse and other leading European stock exchanges suddenly closed. This fateful closing of the European capital markets was reported over the cables to New York. On the momentous morning of July 31, therefore, the New York Stock Exchange was the only great securities market in the world still open, and owing to the universal panic abroad it was threatened with an avalanche of selling orders from Europe, representing a frantic attempt to liquidate here and at once vast amounts of these foreign-owned American stocks and bonds. The untoward event was wisely prevented by the Governing Committee, which a few minutes before 10 A.M. announced the official

closing of the New York Stock Exchange.<sup>18</sup> As the President of the Exchange during that trying time afterwards stated:<sup>19</sup>

. . . the fundamental reason for closing the Exchange was that America, when the war broke out, was in debt to Europe, and that Europe was sure to enforce the immediate payment of that debt in order to put herself in funds to prosecute this greatest of all wars. To use an illustration popular in Wall Street at the time, there was to be an unexpected run on Uncle Sam's Bank and the Stock Exchange was the paying teller's window through which the money was to be drawn out, so the window was closed to gain time.

Once the initial shock was spent, however, the Stock Exchange was reopened gradually and skilfully. Trading in all securities was again permitted by the following December 15, and at once the Exchange became vitally serviceable to the nation under the new and unprecedented conditions imposed by the war.

**Reversal of Our International Trade Balance.**—Obviously, Europe could not maintain her previous volume of exports to us, for her factories, her ships, and her capital were restricted to war production. On the other hand, the Allies soon began to purchase here enormous quantities of all sorts of raw materials and manufactured goods needed to conduct the war. The result was, of course, that our total exports soon threatened vastly to exceed our total imports. It was vitally important for the Allies to prevent such a condition in our trade, lest dollar exchange soar in terms of francs and pounds, and their purchases of war material here prove impossibly expensive. In consequence, Europe soon began to ship us large quantities of gold to offset our impending surplus of exports. But there was not sufficient gold at her disposal to balance the account in this way, and accordingly the vast European pre-war holdings of our securities began to be sold through the New York Stock Exchange to American specu-

<sup>18</sup> See Appendix XVIIIe.

<sup>19</sup> Noble, *The New York Stock Exchange in the Crisis of 1914*, p. 65.

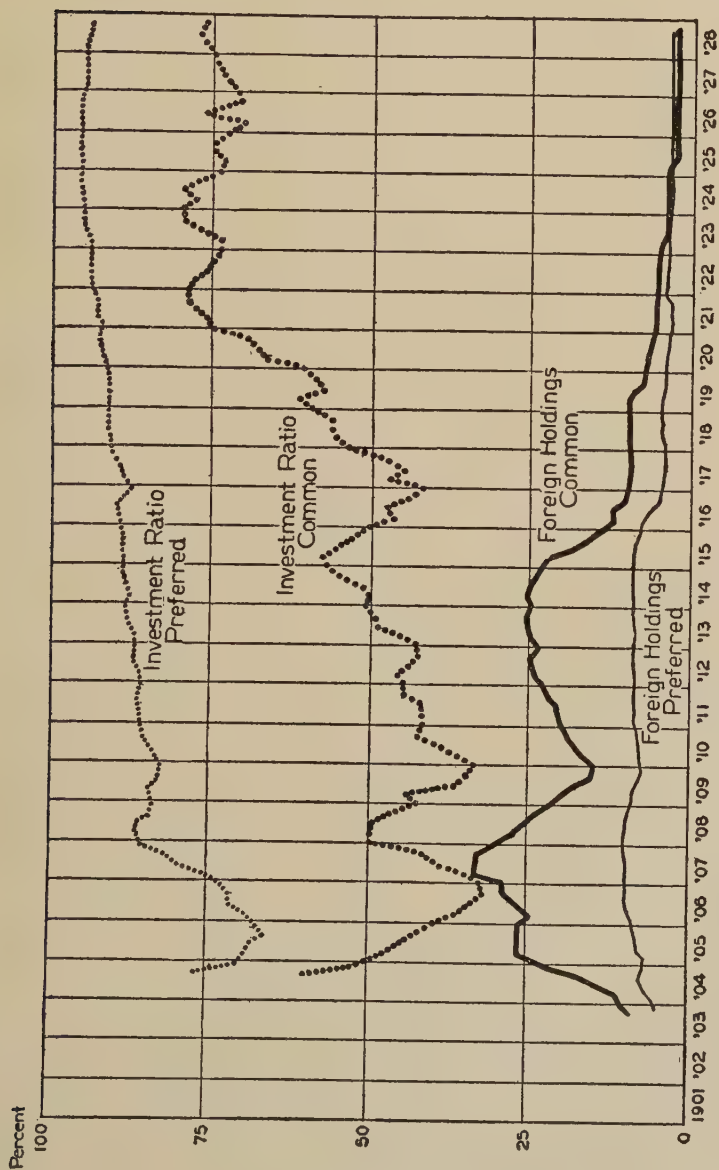


Figure 60. Foreign Holdings of U. S. Steel Preferred and Common Stocks, 1903-1928

lators and investors, to pay for the foodstuffs and munitions which we were steadily furnishing to France and England.

Thus it was through the ready market provided by the Stock Exchange that Europe's former mortgage upon our leading railroad and industrial corporations amounting to billions of dollars was gradually liquidated and paid off, and the large sums which it had previously been necessary for us to send abroad to cover dividends and interest coupons due on Europe's pre-war investment in our corporate shares and obligations, dwindled in proportion. The United States in the next few years not only ceased to be a debtor but became a creditor nation, although these huge amounts of securities were so smoothly and efficiently handled on the great organized securities exchange in New York that this profoundly significant fact attracted little attention at the time except in the technical financial press. The decrease in the foreign holdings of U. S. Steel preferred and common stock during this period will be noted in the accompanying chart (Figure 60).

But the Stock Exchange did not simply make possible the transfer of our long lost stocks and bonds from Europe to our shores. With its aid, the Allies also distributed large external loans to American investors, the colossal Anglo-French 5% loan of \$500,000,000 being the most notable example. It was largely through the instrumentality and the efficient operation of the Stock Exchange, therefore, that after over a century of international indebtedness America became a creditor nation, and that we were enabled to sell and Europe to purchase our huge foreign exports of goods and foodstuffs in 1915 and 1916. This extraordinary trade, so beneficial to us and so vital to the success of the Allied arms, could not have been maintained without the steady and smooth operation of the Stock Exchange.<sup>20</sup>

**The Stock Exchange During the War.**—Equally important from the national standpoint were the services of the

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<sup>20</sup> See Appendix XVIII.f.



Stock Exchange after the United States entered the war. Indeed, by the critical spring of 1917, the liquid resources of Europe in the shape of gold and salable securities were seriously depleted, and it had become increasingly difficult for the Allies to make payment to us for the vast demands which their fighting forces had placed on our fields and factories. Accordingly, when America entered the conflict, the tremendous and still little appreciated task of financing the war was largely shifted from London to Washington, and consequently most of its real burden was likewise transferred from Threadneedle Street to Wall Street. The Allied currencies were accordingly "pegged" near their par rate with dollars, so as to facilitate the continual shipment of our goods abroad. But instead of floating in our market new foreign loans which would have interfered with the sale of our own war bonds, the United States successfully floated the gigantic Liberty loans. Almost half of the many billions received from their sale was devoted to advances made to our Allies practically on open-book account by the United States Treasury, to finance their purchases of materials here. The skilful marketing of the huge Liberty issues on the Stock Exchange, the hearty cooperation of the latter organization with the government in this vital operation, and the gradual distribution effected there among American investors, have already been commented upon.<sup>21</sup> What the Stock Exchange had done for the smaller issues of American corporations or of foreign governments, it did with conspicuous success in the case of the unprecedentedly great Liberty loan issues. Money is in truth the "sinews of war," and the Stock Exchange through its indispensable part in the work of marketing Liberty issues among permanent investors, contributed in no small degree to the successful termination of the war.

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<sup>21</sup> On the work of the New York Stock Exchange in placing the Liberty loans with American investors, consult the statement and testimony of Governor Benjamin Strong of the New York Federal Reserve Bank, before the "Agricultural Inquiry" Commission (Washington, August, 1921), p. 687.

**The Post-Armistice Adjustment.**—To win the war, American commerce, agriculture, industry, and finance had under necessity thrown sound economic principles to the winds. Prices and rates were everywhere artificially “regulated” and restrained. Inevitable as were these developments during the war, after it they became intolerable. As the “controls” were one by one relaxed during 1919–21, long pent-up economic forces vented themselves upon the markets with universal and unaccustomed violence. On the one hand, a hunger for goods long denied by war restrictions seized the world, and commodity prices, bank loans, stock prices, and interest rates everywhere soared. An illusion of unlimited wealth possessed a world temporarily impoverished by the vast sacrifices of the war. In March, 1919, governmental support of the European exchange rates was withdrawn, and these currencies began a precipitous descent which in some cases ended in complete collapse and repudiation. In November, 1919, prices on the New York Stock Exchange began an ominous decline. The silk panic in Japan at the outset of 1920 was succeeded by a universal wave of commodity liquidation that in following months swept the world. To practical panic succeeded a period of stagnation and prostration, which in America reached its nadir in the summer of 1921.

**The Rôle of America.**—The crisis of 1919–21 for many reasons proved less serious and lasting in the United States than in the other great belligerent nations. Unknown to ourselves, we had during the stress of war become the greatest creditor nation in the world. After a century during which we had always owed other nations, this country suddenly found that it had repurchased most of the American securities previously held abroad, and that vast sums were now due our Treasury for sums which it had advanced to other governments during the war. In addition, America had suddenly thrust upon her not only much of the world’s gold supply, but also the unfamiliar rôle of acting as the world’s banker and

money-lender. Despite some serious internal problems, of which our land and agricultural situation was undoubtedly the most acute, the stability of our commodity prices and the revival of our industry and commerce enabled us to enter an epoch not only of great internal prosperity, but also of vast and effective international economic effort.

Before the war, the task of marketing American securities had been largely undertaken by foreign stock exchanges as well as by the New York Stock Exchange, and for this reason the volume of business upon the latter market might be said to have been abnormally small right along. The same thing is, of course, true of loans made on American security collateral—as long as extensive loans of this sort were being carried in London and other foreign centers, to that extent the New York money market was relieved. In consequence, the increase in the extent of New York Stock Exchange operations in many directions after the war, can be largely attributed to the rise of the United States as a creditor nation, and the accompanying inevitable tendency for its principal financial center in New York to handle not only practically all American financing, but also the distribution of foreign securities.

Thus, after the 1919-21 depression, there began an economic process whereby the New World undertook to right the economic balance of the Old. Basically, most of America's efforts in this regard took the specific form of floating and distributing among investors here the security issues of other countries. At first, foreign governments themselves proved the principal borrowers, since governmental finances abroad had to be restored to health before foreign business enterprise could possibly prove stable. Thus dollar bond issues of foreign governments accumulated rapidly upon the New York Stock Exchange list, and in 1925 the Governing Committee enacted special listing requirements for them.<sup>22</sup> Next, with public finances rehabilitated, dollar bond issues of foreign business companies were extensively issued here in steadily increas-

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<sup>22</sup> Appendix IVe.

ing amounts and listed upon the New York Stock Exchange. Foreign company internal shares began to enter the New York market, and in 1927 the Stock Exchange formulated special listing requirements for them.<sup>23</sup> Finally, in 1928, the Exchange listed two large British Government internal war loan issues. On January 1, 1930, there were listed on the New York Stock Exchange 203 foreign government bond issues with a market value of \$15,945,538,473; 129 foreign company bond issues with a market value of \$1,743,022,909; and 32 foreign company share issues with a market value of \$1,460,319,078. All told, therefore, foreign listings amounted to 364 issues possessing a market value of \$19,148,880,460.<sup>24</sup>

The effect of this tremendous expansion in the New York securities market upon American foreign trade balances is readily seen from the admirable estimate of our international payments which the Department of Commerce has made for 1922 and every subsequent calendar year.<sup>25</sup> The classified list of the different items composing our international trade balances for this period, shows that net new long-term investments made abroad by the United States were the largest debit item in our invisible trade during each year except 1923 (Figure 61). The return on American investments abroad has ranked as the leading credit item each year. On the other hand, investments in the United States by foreigners have ranked as the second largest credit item four years, the third largest one year, and the fourth largest one year. These figures clearly indicate the tremendously vital part played in our foreign trade by the international shifting of securities. Without the large debits in our trade balance each year for net investments made abroad, it is difficult to see how we could have had our large credits for "favorable" commodity trade balance which are so vital to American cotton-growers, wheat farmers, and other producers. In effect, the world paid for our surplus of cotton, wheat, etc., by selling us her securities,

<sup>23</sup> See Appendix IVe.

<sup>24</sup> See Appendix XVIIIg.

<sup>25</sup> See Appendix XVIIIh.

which amounts to the fact that it was really the security market of New York that in large measure financed our cotton and wheat exports. Legislative Catos who occasionally delight in demanding the destruction or crippling of the New York Stock Exchange would do well to ponder these statistics.

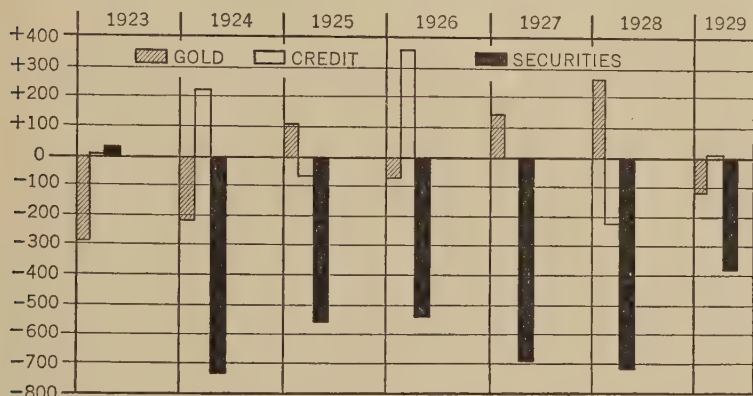


Figure 61. The Invisible Trade Items of Gold, Credit, and Security Sales  
Showing the relative importance of international security transactions in 1924-1929 in the U. S. Balance of Trade. Based on net statistics in Appendix XVIIIi.

The figures above cited also show the great comparative importance of securities as a vehicle for balancing the international trade account.<sup>26</sup> In every year since 1923, security balances were greater than gold and credit balances combined. Obviously, therefore, the maintenance of liquid securities markets in this country plays a highly important part in maintaining the flexibility of our foreign trade, and the more negotiable securities can be rendered by stock exchange operations the greater will be the strain thereby removed from our supplies of gold and bank credit. It was this fact primarily that induced the Exchange in 1928 to list the two huge British sterling war debt issues.

#### Economic Functions of Foreign Security Investments.—

The transformation of the United States into an international creditor nation has occurred so swiftly that as yet our modes

<sup>26</sup> See Appendix XVIIIi.



of thought and our specific financial practices have failed to keep pace with our actual economic status. Yet, both from our own experience and from that of the older creditor nations of Europe,<sup>27</sup> it is possible to generalize as to the benefits which foreign security investing can be expected to confer upon the United States, and also as to some of the problems and dangers which may thereby arise.

The relationship between foreign security investments and righting foreign trade balances has already been discussed, and may here be only summarized. Foreign security investing renders all foreign trade more flexible because it furnishes an additional and flexible method of payment. It thus lightens the pressure upon gold stocks and gold shipments, as well as upon the shifting internationally of bank credit and short-loans; in consequence, it may be said to stabilize foreign exchange rates and both domestic and foreign interest rates, to minimize any tendency for commodity inflation, and to assist the work of the great central banks in stabilizing foreign and domestic business. Foreign security investing in general tends to increase both exports and imports. Then export of capital often directly creates foreign demand for the export of domestic goods, and indirectly raises foreign productive power and income so as to permit a greater export of goods from the lending to the borrowing nation.<sup>28</sup> Conversely, the lending nation can afford to spend interest and dividends accruing on its foreign investments to pay for imports of foreign goods.

In the second place, a nation benefits from making and holding foreign security investments in much the same way that an individual does from owning any securities. In each case a surplus of negotiable wealth is stored up and kept at hand to meet all possible exigencies. The nation which holds sound foreign securities listed on its own or foreign stock exchanges can usually obtain instant funds abroad with which

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<sup>27</sup> An admirably impartial summary, from the pre-war British viewpoint, of the advantages and disadvantages of foreign investment, may be found in the introduction (pp. xviii-xxv) to C. K. Hobson's classic study, "The Export of Capital."

<sup>28</sup> See Stabilization Hearings, pp. 300 and 365.

to pay foreign debts or to purchase foreign goods and services.<sup>29</sup> Useful as this ability is in peace times, it has frequently proved a decisive factor in war. Certainly in the World War if Great Britain had not possessed many hundred million dollars of American securities negotiable on the New York Stock Exchange, it might have been impossible for her to have made the vast purchases of foodstuffs and munitions here which proved so vital to victory.

Income as well as principal of foreign securities also, of course, conveys benefits upon the creditor nation. Such income in fact represents the amount over earned domestic income which a nation with foreign investments has at its disposal to save or spend. Such foreign revenue ("unearned income" in the jargon of our income tax collectors) enables the recipient country to command imports of goods from other countries in excess of its own exports of goods. Frequently this fact has been taken advantage of by creditor nations; British investments in Argentine railways, for example, enabled Britain to accumulate funds there for the purchase of Argentine wheat and beef, and at the same time to assist in building up the great new South American country. Sometimes, however, interest and dividends accruing to a foreign creditor nation are saved instead of spent, and this usually results in increasing the negotiable wealth and "unearned income" of the creditor country.

Lastly, foreign investments do much to extend abroad the political and commercial influence of the lending nation, to promote a wider and more sympathetic understanding of foreign countries and international problems, and to promote peace.

The above benefits from foreign security investments, however, all postulate the existence and efficient operation of stock exchanges, particularly in the creditor country, but also in the debtor countries. In these respects, foreign securities are

<sup>29</sup> See Appendix XVIIIj.

beneficial in proportion as they are negotiable, and it is stock exchanges which confer this quality of negotiability on securities. The world's stock exchanges as truly furnish warehousing facilities and points of arrival and departure for securities internationally dealt in, as do the great ports and storehouses for the "visible trade." Without stock exchanges, the shifting of securities from one nation to another would not readily occur. Apart from their vast domestic economic services, therefore, stock exchanges would still amply justify their existence simply for the invaluable services which they perform in respect to foreign trade. And true as this is in times of war and national peril, it is even more profoundly true in times of peace.

**Dangers of Foreign Investment.**—From the foregoing summary of the potential benefits of foreign security investment, the conclusion must not be drawn that such benefits are inevitable, or that there are not also potential dangers in the process which also deserve careful consideration.

The first of these dangers may be referred to briefly as the development on the part of the lending nation, of an "imperialistic" attitude toward debtor countries. It can scarcely be denied that this has occasionally happened with the old creditor nations of Europe. Politics and finance have always gone hand in hand on the Continent, and tendencies toward a similar situation might be cited even in the past history of Great Britain. Cases have occurred where the creditor nation's navy has been pressed into service to collect, or attempt to collect, defaulted bond coupons. Illogical political alliances have sometimes been formed on the basis of a creditor-debtor relationship. If our new financial creditor nation is to possess in this respect a less "imperialistic" record than those of older creditor countries, it will be due not so much to any superior moral character on our part, but to sound underwriting principles, lack of government interference in finance, and an

intellectual ability to profit by the mistakes which others have made.<sup>30</sup>

An even more complex problem, not without possible danger to our national interests, arises from financing foreign industrial production which may come to compete successfully with our own. On this score, Hobson said in respect to British investments in the United States, ". . . it might be urged that the export of capital to America had hastened the day when Great Britain should become a relatively insignificant power in moulding the destinies of the world."<sup>31</sup> It seems obvious that it is more to a creditor country's advantage to build up productive facilities in the debtor state for non-competing products, such as railway transportation, electric power and light, and the like. Yet even here reduced manufacturing or transportation charges within the debtor country may in fact materially cheapen the price of its competing exports in the international markets. On the other hand, creditor communities can sometimes profit more from investments in new and distant competing industries, than from endeavoring to protect their own industries against inevitable shifts in production centers; it is, for example, well known that the astonishing development of textile mills in North Carolina has largely been accomplished with Massachusetts capital.

Of course, all arguments regarding the benefits of foreign investment fail if such investments are in poor securities and result in heavy or complete losses to the lenders. In this regard, it is better to give money away freely as a charity, than to lose it, and also litigation expenses, grudgingly. Such unsuccessful investments also are apt to have the same evil effect upon the borrowers as promiscuous and unwise charity is apt to upon habitual beggars. If we cannot invest safely abroad, it would probably be better not to invest at all. Thus far, however, losses to American investors on foreign securi-

<sup>30</sup> See Address of President E. H. H. Simmons, "The Myth of American Imperialism," Washington, D. C., February 17, 1929.

<sup>31</sup> See C. K. Hobson's "Export of Capital," p. xviii.

ties have been comparatively insignificant when compared to our vast total foreign investments.

The test of successful investment, foreign as well as domestic, is apt to consist in whether its purpose is productive. Loans to foreign governments to be used in building up armaments are not of course in this category, and for just this reason may harm investors as well as hostile powers; the great losses suffered during the war by French investors largely arose from the fact that they had been financing both sides of the irrepressible Balkan conflict. If foreign loans are made for really productive purposes, their effect is to increase the debtor's wealth, to enable ready payment of interest and repayment of principal, and to raise wages and improve standards of living in the debtor nation. Dr. Schacht, then President of the Reichsbank, was fundamentally right, however, when he criticized certain German municipalities for borrowing funds here at high rates of interest to build stadia and war memorials. In the past, non-productive foreign loans to new communities in Africa and South America have had a more sinister outcome. Hobson even declares that "capital has been employed in numerous instances to drain countries of their resources, to weaken them economically, and to degrade them morally." Certainly the record during the nineteenth century of foreign loans made by European nations affords sufficient cases where great burdens of public debt have been thrust upon ignorant and impoverished peoples through the irresponsible greed of their temporary political leaders. In some cases, European underwriters must share blame with the grafters who alone benefited from the proceeds of the loans.

Finally, there is the danger that too many foreign investments may endanger the moral fibre of the creditor people by encouraging them in laziness, vices, and luxurious expenditures. Such fears, of course, apply almost as well to domestic as to foreign investment, and belong as much in the sphere of morals as of economics. It may be, of course, that America



too may experience a decline and fall like Rome's, but at present this contingency seems still remote.

**Needs for Constructive Foreign Investing.**—Many sound and constructive steps have already been taken to render foreign investment safe and beneficial, but many still remain to be taken. The first need is adequate publicity concerning foreign borrowers and companies; here the special listing requirements recently established by the New York Stock Exchange have already proved valuable.<sup>32</sup> Our financial press is also rapidly acquainting itself with the details and past record of foreign financing, and developing a more experienced and critical attitude toward it. Rival American investment banking firms are also learning that over-active competition for foreign financing sometimes results in issues here which do not sufficiently protect the lending investors.

International cooperation, especially between the leading stock exchanges, has still to be mobilized as a protective factor in foreign investment, yet it could obviously accomplish many desirable results.<sup>33</sup> There is a real need today of concerted action between the leading stock exchanges to bar from their lists loans unfairly defaulted, and company securities of a questionable character. Statistics concerning the world's stock markets are also deplorably inadequate, despite the patent economic importance of the subject; security price indices, for example, although a daily necessity for measuring stock markets, are surprisingly inconclusive, unscientific, and even misleading. No real quantitative understanding of stock exchange functions is possible without comprehensive and accurate statistics. More complete understanding between the different great stock markets of the world could do much to broaden the market for the securities of practically all countries by removing obstacles to free international security dealings.

**America's Economic Maturity.**—The United States is today entering into the period of its economic maturity. From

<sup>32</sup> See Appendix XVIIIk.

<sup>33</sup> See Appendix XVIIIll.

the early colonial days till the middle of the last century, our country was still in its economic infancy. Our nation's early manhood was spent from 1850 to 1914 in perfecting our means of transportation, founding our national industries, and creating the bulk of our modern credit machinery. But in the few amazing years since 1914 we have, as regards our international economic position, experienced by far the swiftest development of which history holds any record. In less than a decade, America attained an international economic and financial preeminence which a full century of normal growth and development might well have failed to bring about. But this preeminence, flattering as it may be to our national self-esteem, brings with it a vast and heavy responsibility which we cannot evade or shirk, and nowhere more than in Wall Street today. New York has become the leading money and credit center of the world.

Not merely the scope, but also the character of American financial methods are being tested by the new status of the United States as a creditor nation. For over a century our financial practices and institutions developed while we were a debtor country, in which funds were usually harder to obtain than profitable uses for them. But now that we are a creditor country, we are discovering that our present problems are arising from the excess of our capital and credit over and above the safe and profitable uses for them. Thus we are attempting to function as a creditor nation with the viewpoint, methods, and institutions largely developed under debtor conditions. Already the pressure of unaccustomed economic factors has led to many unfamiliar developments in American finance, and if we are to remain a successful creditor country it is not unlikely that very far-reaching adjustments and innovations throughout American financial methods must be made. The practical application of this theoretical assertion will in coming years test very thoroughly the ability of America in constructive finance.

**Future International Rôle of the New York Stock Exchange.**—In the vast international vistas of commercial and financial development which destiny is thus opening before our people, the New York Stock Exchange has a vital rôle to play in behalf of our national future. Its free and open market must function not only as our principal domestic securities exchange, but also as a world market comparable in scope and power to our new world position. We must look upon it as an indispensable part of the national business machinery in times of peace, and if the occasion shall arise, as a huge bulwark of economic and financial strength in times of war. We are justified in feeling a sense of national pride in its rapid growth and swift efficiency, since it so well embodies both the level-headed sagacity and the progressive and daring enterprise of our people.

America today enters this future period of international financial preeminence with a confidence for the future grounded firmly in the achievements of the present. And yet, in the coming years, our vision must be comparable in breadth and depth to the task which fate has set for us. The philosopher, Edmund Burke—that true friend of American political destinies—once declared, “Great empires and little minds go ill together.” If this is true of the governmental problems of empires, it is a hundred times truer of the present and future “empires of business.” The United States has entered its economic maturity. We have ceased, once and for all, to be a parochial nation on the fringes of modern civilization, nor can we longer judge our economic problems simply with the outlook and the philosophy of the impoverished country villager. We should, with regard to the future of this country, have something of the spirit and viewpoint of the British poet who said concerning his own people:

We've sailed wherever ships can sail  
 We've founded many a mighty state,  
 God grant our greatness may not stale  
 Through craven fear of being great.

As Americans, therefore, we must, in our judgment of our economic problems, present and future, clear our minds of sectional prejudices, political opportunism, economic fallacy, and mere traditionalism. We must not allow those business organizations and institutions which perform genuine services to the United States, to become the target of demagogic abuse, or the victim of rashly conceived and nationally dangerous legal experiments. A great responsibility for our economic future today rests upon the members and governors of the New York Stock Exchange. In the difficult tasks which may arise before them in coming years, their hands must be upheld by a wise and patriotic public opinion.

# APPENDIX

## CHAPTER I

### The Evolution of Securities

(Ia) Very complete historical data upon the early governmental financing in Antwerp can be found in "Capital and Finance in the Age of the Renaissance," by Richard Ehrenberg.

(Ib) The continual growth of the British national debt through recurrent warfare is shown in the following table, taken from "The Political Economy of War," by F. W. Hirst, and from "National Debt Return" (1920), Cmd. 429:

| Date | Total Debt    | Historical Events                                         |
|------|---------------|-----------------------------------------------------------|
| 1689 | £ 664,000     | Revolution—Parliament obtained financial control.         |
| 1697 | 21,515,000    | War of League of Augsburg added.... £ 20,851,000— 8 years |
| 1702 | 16,394,000    | Peace reduced debt by ..... 5,121,000— 5 years            |
| 1713 | 52,145,000    | War of Spanish Succession added.... 35,751,000—11 years   |
| 1739 | 47,954,000    | Peace reduced debt by ..... 4,190,000—26 years            |
| 1748 | 79,293,000    | War of Jenkins' Ears added..... 31,339,000— 9 years       |
| 1756 | 74,332,000    | Peace reduced debt by ..... 4,961,000— 8 years            |
| 1763 | 138,865,000   | Seven Years' War added..... 64,533,000— 7 years           |
| 1775 | 128,584,000   | Peace reduced debt by ..... 10,281,000—12 years           |
| 1783 | 249,851,000   | American War added..... 121,267,000— 8 years              |
| 1793 | 244,118,000   | Peace reduced debt by ..... 5,733,000—10 years            |
| 1816 | 885,000,000   | Napoleonic Wars added..... 640,882,000—23 years           |
| 1854 | 803,000,000   | Peace reduced debt by ..... 82,000,000—38 years           |
| 1857 | 836,000,000   | Crimean War added..... 33,000,000— 3 years                |
| 1899 | 635,000,000   | Peace reduced debt by ..... 201,000,000—42 years          |
| 1903 | 798,000,000   | Boer War added..... 163,000,000— 4 years                  |
| 1914 | 706,000,000   | Peace reduced debt by ..... 92,000,000—11 years           |
| 1919 | 7,481,000,000 | War 1914-1918 added..... 6,775,000,000— 4 years           |

(Ic) "We have entirely lost the idea that any undertaking likely to pay, and seen to be likely, can perish for want of money; yet no idea was more familiar to our ancestors, or is more common now in most countries. A citizen of London in Queen Elizabeth's time could not have imagined our state of mind. He would have thought it was of no use inventing railways (if he could have understood what a railway meant), for you would not have been able to collect the capital with which to make them. At this moment, in colonies and all rude countries, there is no large sum of transferable money, and there is no fund from which you can borrow and out of which you can make immense works. Taking the world as a whole—either now



or in the past—it is certain that in poor states there is no spare money for new and great undertakings, and that in most rich states the money is too scattered, and clings too close to the hands of the owners, to be often obtainable in large quantities for new purposes. A place like Lombard Street, where in all but the rarest times money can always be obtained upon good securities or upon decent prospects of probable gain, is a luxury which no country has ever enjoyed with even comparable equality before.” (Walter Bagehot, “Lombard Street,” 1878.)

(Ie) If the old stock in the railroad company cited sells at 115 on the Exchange, while the subscription price to holders of a “right” for new stock is 100, the value of the right is determined in the following manner: Each purchaser or holder of 10 shares of old stock at 115 can acquire another share, or 11 shares altogether, with an additional \$100. Thus his 11 shares will be worth \$1,250, or \$113.63 apiece. But since the old stock is selling at \$115 per share, the value of a right would amount to the difference between these figures, or to \$1.37 per right. If such rights were listed upon the Exchange, they would be quoted at about 13½.

(Id) The issues listed upon the New York Stock Exchange on January 1, 1930, classified according to sources of issue, were as follows:

#### GOVERNMENT BONDS

| U. S. GOVERNMENT                  |  | Gov't |  | Issues |  |
|-----------------------------------|--|-------|--|--------|--|
| U. S. Federal                     |  | 1     |  | 12     |  |
| U. S. Territories and Possessions |  | 1     |  | 6      |  |
| U. S. States and Counties         |  | 3     |  | 22     |  |
| U. S. Cities                      |  | 3     |  | 25     |  |
| Total U. S.                       |  | 8     |  | 65     |  |

| FOREIGN GOVERNMENT | National |        | Subdivisional |        | Total |        |
|--------------------|----------|--------|---------------|--------|-------|--------|
|                    | Gov't    | Issues | Gov't         | Issues | Gov't | Issues |
| Africa             | 0        | 0      | 0             | 0      | 0     | 0      |
| Asia               | 2        | 6      | 3             | 3      | 5     | 9      |
| Australasia        | 1        | 3      | 3             | 6      | 4     | 9      |
| Europe             | 19       | 44     | 36            | 48     | 55    | 92     |
| North America      | 5        | 17     | 0             | 0      | 5     | 17     |
| South America      | 10       | 36     | 20            | 40     | 30    | 76     |
| Total Foreign      | 37       | 106    | 62            | 97     | 99    | 203    |

|                                          |    |     |    |     |     |     |
|------------------------------------------|----|-----|----|-----|-----|-----|
| Total U. S. and Foreign Government Bonds | 39 | 124 | 68 | 144 | 107 | 268 |
|------------------------------------------|----|-----|----|-----|-----|-----|

## CORPORATE BONDS AND STOCKS

| Classes of Industry                                          | Bonds   |        | Stocks  |        | Total  |
|--------------------------------------------------------------|---------|--------|---------|--------|--------|
|                                                              | Issuers | Issues | Issuers | Issues | Issues |
| Automobiles.....                                             | 4       | 4      | 58      | 72     | 76     |
| Finance.....                                                 | 7       | 10     | 24      | 36     | 46     |
| Chemicals.....                                               | 8       | 9      | 49      | 74     | 83     |
| Building.....                                                | 7       | 7      | 18      | 26     | 33     |
| Electrical Equipment.....                                    | 4       | 4      | 13      | 20     | 24     |
| Foods.....                                                   | 17      | 20     | 52      | 84     | 104    |
| Farm Machinery.....                                          | ..      | ..     | 7       | 13     | 13     |
| Machinery and Metals.....                                    | 13      | 15     | 57      | 86     | 101    |
| Amusements.....                                              | 5       | 5      | 19      | 26     | 31     |
| Land, Realty and Hotels.....                                 | 7       | 8      | 6       | 8      | 16     |
| Mining.....                                                  | 22      | 33     | 41      | 55     | 88     |
| Petroleum.....                                               | 25      | 32     | 48      | 60     | 92     |
| Paper and Publishing.....                                    | 6       | 9      | 19      | 27     | 36     |
| Chain Stores.....                                            | 1       | 1      | 31      | 45     | 46     |
| Department Stores.....                                       | 2       | 2      | 24      | 39     | 41     |
| Mail Order Houses.....                                       | ..      | ..     | 3       | 3      | 3      |
| Miscellaneous Distributors.....                              | 1       | 1      | 6       | 12     | 13     |
| Railroads.....                                               | 298     | 675    | 91      | 157    | 832    |
| Railroad Holding Cos.....                                    | 3       | 10     | 2       | 3      | 13     |
| Railroad Equipments.....                                     | 3       | 3      | 15      | 22     | 25     |
| Steel, Iron & Coke.....                                      | 21      | 29     | 34      | 49     | 78     |
| Textiles.....                                                | 5       | 6      | 26      | 38     | 44     |
| Airplanes, Airports, etc.....                                | ..      | ..     | 7       | 9      | 9      |
| Gas and Electric.....                                        | 71      | 105    | 23      | 38     | 143    |
| Gas and Electric (Holding).....                              | 6       | 11     | 16      | 35     | 46     |
| Cable, Tel., Tel., & Radio.....                              | 16      | 30     | 9       | 13     | 43     |
| Tractions.....                                               | 31      | 51     | 12      | 22     | 73     |
| Omnibus Cos.....                                             | ..      | ..     | 3       | 4      | 4      |
| Express Cos.....                                             | 1       | 1      | 4       | 5      | 6      |
| Water & Central Heating.....                                 | 3       | 3      | 3       | 6      | 9      |
| Business Equipment.....                                      | 2       | 2      | 8       | 12     | 14     |
| Shipping Services.....                                       | 4       | 7      | 5       | 8      | 15     |
| Ship Bldg. & Operating.....                                  | 2       | 2      | 7       | 8      | 10     |
| Garment Manufacturers.....                                   | ..      | ..     | 7       | 13     | 13     |
| Leather and Boots.....                                       | 1       | 1      | 11      | 21     | 22     |
| Tobacco.....                                                 | 2       | 5      | 19      | 40     | 45     |
| Rubber.....                                                  | 5       | 6      | 10      | 20     | 26     |
| U. S. Cos. Operating Abroad.....                             | 23      | 37     | 26      | 41     | 78     |
| Miscellaneous Businesses.....                                | 2       | 2      | 8       | 11     | 13     |
| UNITED STATES COMPANIES.....                                 | 628     | 1,146  | 821     | 1,261  | 2,407  |
| FOREIGN COMPANIES.....                                       | 89      | 129    | 25      | 32     | 161    |
| TOTAL U. S. AND FOREIGN CORPORATE & GOVERNMENT SECURITIES... | 824     | 1,543  | 846     | 1,293  | 2,836  |

(If) In the summer of 1927 a special commission from the New York Stock Exchange, consisting of J. M. B. Hoxsey (Executive Assistant to the Committee on Stock List), J. E. Meeker (Economist to the Exchange) and R. L. Redmond (of Counsel for the Exchange), made a thorough investigation of foreign security practices in Europe in the course of studying the problem of listing foreign shares. The commission's findings were published September 1, 1927, as a pamphlet entitled "The Listing of Foreign Internal Securities on the New York Stock Exchange"; subsequently, this study was made the basis for the special listing requirements adopted for such securities. At this writing, complimentary copies of the pamphlet can be obtained from the Exchange by special students.

(Ig) Owners of American bearer bonds who have been dispossessed of their certificates by theft or loss can usually place a "stop" upon them by communicating their certificate numbers to the company or fiscal agency charged with this service. This "stop" can be communicated to such institutions as might cash coupons for the wrongful holder, yet it is difficult by this means to detect a thief who may in the meantime have sold the bond to an innocent third party.

American law very thoroughly protects the latter party, provided he has purchased the stolen security in good faith. The chance of the dispossessed owner to recover his security therefore depends in practice mainly in preventing its negotiation. Yet this is also difficult to do if he does not discover his loss and report it to the proper quarters at once.

The New York Stock Exchange does what it can to prevent negotiation of improperly acquired certificates. On receiving notification from a transfer office or agent, or directly from its members, the Exchange prints the title of the security, amount and number (or numbers) on its tape, as a warning to Exchange members and banks that the given security (or securities) has been "stopped." So many leading American companies employ the large New York trust companies as transfer or fiscal agents, that these institutions are in practice the chief repository for security numbers which have been "stopped."

## CHAPTER II

### Organized Financial Markets and Their Economic Functions

#### (IIa) Stock exchanges of the world.

(AUTHOR'S NOTE: The following list of stock exchanges has been taken from a careful compilation made in 1922. No especial claim is made for

its accuracy, however, because of the great territorial and economic changes resulting from the Great War. Also, new exchanges are continually being created, and old ones occasionally disappear. There is, too, a serious problem of definition and classification. The following list is therefore given for what it may be worth, but probably it is substantially correct.)

AFRICA: *Egypt*, Alexandria; *Morocco*, Casablanca; *Union South Africa*, Johannesburg, Pietermaritzburg.

ASIA: *China*, Shanghai; *Japan*, Kioto, Kobe, Nagoya, Osaka, Tokyo, Yokohama and 3 others; *Dutch East Indies*, Batavia; *Hawaii*, Honolulu.

AUSTRALASIA: *Australia*, Adelaide, Ballarat, Bendigo, Castlemaine, Charters Towers, Gympie, Hobart, Launceston, Maryborough, Melbourne, Perth, Ravenswood, Sidney; *Queensland*, Brisbane.

EUROPE: *Austria*, Vienna; *Belgium*, Antwerp, Bruges, Brussels, Ghent, Liege, Louvain, Termonde; *Czechoslovakia*, Prague; *Denmark*, Copenhagen; *Finland*, Abo, Helsingfors; *France*, Bordeaux, Lille, Lyons, Marseilles, Nantes, Paris, Coullisse, Paris Parquet, Rouen, Toulouse; *Germany*, Augsburg, Berlin, Bremen, Breslau, Brunswick, Cologne, Dresden, Dusseldorf, Essen, Frankfurt, Halle, Hamburg, Hanover, Konigsberg, Leipzig, Lubeck, Mannheim, Mayence, Meusel, Munich, Stuttgart, Zwickau; *Great Britain*, (including Ireland) Aberdeen, Belfast, Birmingham, Bradford, Bristol, Cardiff, Cork, Dublin, Dundee, Edinburgh, Glasgow, Greenock, Halifax, Huddersfield, Leeds, Liverpool, London, Manchester, Newcastle-on-Tyne, Newport, Nottingham, Sheffield, Swansea; *Greece*, Athens; *Hungary*, Budapest; *Italy*, Bari, Bologna, Cagliari, Catania, Florence, Genoa, Livorno, Messina, Milan, Naples, Palermo, Rome, Trieste, Turin, Venice; *Jugoslavia*, Agram, Belgrade; *Netherlands*, Amsterdam, Arnheim, Assen, Deventer, Groningen, Hague, Leeuwarden, Leyden, Limburg, Nymwegan, Rotterdam, Zwolle; *Norway*, Aalesund, Bergen, Christiania, Christiansand (2), Drammen, Dronheim, Skavanger, Skien; *Poland*, Warsaw; *Portugal*, Lisbon, Oporto; *Roumania*, Bucharest; *Russia* (owing to political revolutions, only market of importance the reconstructed Moscow Stock Exchange; before the war, there were the following stock exchanges:) Astrakan, Baku, Berdyansk, Elez, Kasan, Kinsk, Kharkov, Kiev, Moscow, Nikolayevska, Novo-Rissysk, Odessa, Omsk, Orlov, Perm, Petrograd, Reval, Riga, Rostov-on-Don, Rybinsk, Samara, Saratov, Simbirsk, Sloboda, Sysran, Tagaurog, Tambov, Vindava, Vladivostok); *Spain*, Alicante, Bilbao, Cadiz, Coruna, Madrid, Malaga, Palma de Mallorca, San Sebastian, Santander, Sevilla, Tarragona, Valladolid, Valencia, Zaragoza; *Sweden*, Stockholm; *Switzerland*, Basle, Geneva, Zurich; *Turkey*, Constantinople.

NORTH AMERICA: *Canada*, Montreal, Toronto (2), Winnipeg; *United States*, Baltimore, Boston (2), Chicago, Cincinnati, Cleveland, Colorado Springs, Columbus, Detroit, Hartford, Indianapolis, Los Angeles, Louisville, New Orleans, New York (2), Philadelphia, Pittsburgh, Providence, Richmond, Salt Lake City, San Francisco, St. Louis, Seattle, Spokane, Washington, Wheeling.

SOUTH AMERICA: *Argentine*, Buenos Aires; *Brazil*, Rio de Janeiro, Santos, Sao Paula; *Chile*, Caldera, Concepcion, Constitucion, Copiapo, Co-

quimbo, Huasco, San Antonio, Santiago, Serena, Talca, Talcuhuano, Tome, Valparaíso; *Peru*, Lima; *Uruguay*, Montevideo; *Venezuela*, Caracas.

(IIb) U. S. Internal Revenue receipts from Federal taxes on stock transfers, and on sales of produce on exchanges (ooo omitted):

| Fiscal<br>Years<br>Ending<br>June 30 | STOCK TRANSFERS |                     |             | SALES OF PRODUCE ON EXCHANGES |                     |             |         |              |
|--------------------------------------|-----------------|---------------------|-------------|-------------------------------|---------------------|-------------|---------|--------------|
|                                      | U.S.A.          | New<br>York<br>City | %<br>N.Y.C. | U.S.A.                        | New<br>York<br>City | %<br>N.Y.C. | Chicago | %<br>Chicago |
| 1921.....                            | \$8,790         | \$7,888             | 89.7        | \$7,521                       | \$1,521             | 20.2        | \$4,576 | 60.8         |
| 1922.....                            | 9,012           | 8,165               | 90.6        | 5,558                         | 1,378               | 24.8        | 3,107   | 55.9         |
| 1923.....                            | 9,871           | 8,808               | 89.2        | 7,015                         | 3,025               | 43.1        | 2,250   | 32.0         |
| 1924.....                            | 7,936           | 7,105               | 89.5        | 7,557                         | 3,845               | 50.9        | 1,446   | 19.1         |
| 1925.....                            | 12,808          | 11,690              | 91.2        | 5,397                         | 1,610               | 29.8        | 2,804   | 51.9         |
| 1926.....                            | 17,137          | 15,631              | 91.2        | 4,183                         | 1,095               | 26.2        | 2,425   | 57.9         |
| 1927.....                            | 16,674          | 15,250              | 91.4        | 2,884                         | 813                 | 28.2        | 1,647   | 57.1         |
| 1928.....                            | 24,208          | 21,861              | 90.3        | 4,048                         | 1,379               | 34.0        | 1,960   | 48.4         |
| 1929.....                            | 37,595          | 33,580              | 89.3        | 3,333                         | 1,206               | 36.1        | 1,456   | 43.6         |

(IIc) In the "Agricultural Inquiry" of 1921 (pp. 684-686), the late Governor Strong of the New York Federal Reserve Bank testified:

The security markets—that is, the markets through which the raising of new capital for the industries of the country is effected—are and must be the markets where the greatest amount of capital naturally gravitates; I mean that is the point where the flow of funds concentrates for the purpose of investment and reinvestment to a greater extent than in any other market in the country.

That is especially true of the money centers of the world—London, Berlin, Tokyo—and I think also we must all recognize that it is not a man-made affair. It is a natural law, I think more primarily due to the fact that the great flow of foreign and domestic commerce of the United States is into and out of the port of New York than to any other factor.

*Representative Sumners.* The theory, at least, of the economic function of the exchange is that it provides a meeting place for the persons who want to buy and the people who want to sell these securities?

*Governor Strong.* Yes, sir.

*Representative Sumners.* And the sales of the securities are found to be necessary from time to time in order to acquire the necessary capital for starting new enterprises and maintaining established enterprises, in developing established enterprises?

*Governor Strong.* It is an essential part of the machinery for purposes of that nature, if you please, and has contributed to the development of the resources of the country by the direction of the flow of capital into new enterprise. That is where the management, if you please, is undertaken, for a commission or for a brokerage, for this direction of the stream of savings of the Nation into new enterprises. . . .

It is a significant fact that, since the earliest times, the tendency in trade has been continually for those people trading in certain things to group together, and in the bazaars of India today you will find all of the jewelry markets in one place, all of the silk in another, and all of the money,



brokers in another. They gravitate together because that makes a market, and markets make values certain.

(II*d*) Conant in his "Wall Street and the Country" (pp. 92-93) asked the then hypothetical question, "Suppose for a moment that the stock markets of the world were closed, that it was no longer possible to learn what railways were paying dividends, what their stocks were worth, how industrial enterprises were faring—whether they were loaded up with surplus goods or had orders on hand. Suppose that the information afforded by public quotations on the stock and produce exchanges were wiped from the slate of human knowledge. How would the average man, how even would a man with the intelligence and foresight of a Pierpont Morgan, determine how new capital should be invested? He would have no guides except the most isolated facts gathered here and there at great trouble and expense. A greater misdirection of capital and energy would result than has been possible since the organization of modern economic machinery." It is interesting to reflect that in large measure, just this situation resulted when the world's stock exchanges closed at the outbreak of the war in 1914, and just the predicted chaos occurred. But in 1914 there was the further problem that it was not so much a question of knowing how to invest more, as knowing whether, under the circumstances, one really had anything to invest!

(II*e*) "There is a difference in the effect of inflation in one kind of business from that which obtains in another . . . It is speculation in land and speculation in inventories that I fear more than speculation on the Stock Exchange. Speculation on the Stock Exchange may be an evil, but it is an evil which is quickly corrected. In the event of a sharp decline in securities on the Stock Exchange various individuals who have been speculating in the hope of a rise, may lose money, actual money or paper profits; but the loss in the main is confined to those individuals. When, however, the volume of bank credit is extended to an excessive extent to those who are engaged in industry, leading to inflated inventories, you have a collapse of a large number of industrial concerns and resulting unemployment.

"The situation is even worse if it happens in the case of agricultural lands. If agricultural lands reach a price which is not justified by current income, actual or prospective in the immediate future, the damage is ten-fold greater than it would be from a decline on the Stock Exchange, and much greater than in industry, because the farmer's home is attached to his occupation, and often he cannot liquidate, without breaking up his home, as well as his occupation. Thus you have in the case of inflated farm-land values a long and painful

period for which you have no analogy whatever in the case of industry, and much less in the case of the Stock Exchange."—Testimony of Prof. O. W. M. Sprague of Harvard, in the La Follette hearings, pp. 33-35.

(IIIf) In recent Federal government hearings, the barometric character of the stock market was frequently alluded to. Mr. W. R. Burgess, Assistant Federal Reserve Agent in New York stated (Stabilization hearings, p. 1010) ". . . the most sensitive index of changes in the New York money market is, of course, the call loan rate." Professor J. R. Commons declared (Stabilization hearings on amended bill, p. 100), "The stock market is a speculation on what that future prosperity is going to be, and we have enough of this situation to make it rather a consistent statement that in any period of rise and fall of prices the first market to be affected is that most elastic market, which is the stock market. It is going to hit there first; it is going to raise their prices first or cause them to decline first. They are a kind of a forecaster of what is to follow."

Speaking of the relationship between the stock market and general business conditions, Professor O. W. M. Sprague (La Follette Resolution hearings, p. 54) declared, "I do not think that the evidence indicates that a decline on the stock exchange is an independent cause of business or industrial reaction. It is undoubtedly true that almost invariably trade reaction is accompanied or perhaps preceded by decline on the stock exchange, but there are plenty of other instances when declines on the stock exchange have not been accompanied or preceded by declines in general business. If the undue advance in the price of securities is purely a credit matter, and business in general is in sound condition, the reaction in the market would not plunge the country into a period of business depression. I therefore reach the conclusion that the brokers' loan evil is at the worst an evil of minor consequence, not one of such serious import that we need to sacrifice any other desirable interest in the community in order to hold that matter in leash."

## CHAPTER III

### The Rise of the New York Stock Exchange

(IIIa) "From 1792 to 1801 the number of banks increased from 3 to 23, with a total capital of \$33,550,000. A few fire and marine insurance companies had also been organized. The supply of securities available for investment and speculation made therefore quite a stock market. The following advertisement, which appeared in the

first issue of the *Evening Post*, November 16, 1801, gives an idea of the dimensions of this market:

## PRICES OF STOCKS

|                      |                       |
|----------------------|-----------------------|
| 6 % Funded Debt..... | 98 $\frac{3}{4}$ %    |
| 3 % .....            | 56 $\frac{1}{2}$ a 57 |
| 8 % Loan.....        | 112 $\frac{1}{2}$     |
| 6 % Navy Loan.....   | par                   |

## BANK STOCK

|                              |                           |
|------------------------------|---------------------------|
| United States Bank.....      | 143 a 143 $\frac{1}{2}$ % |
| New York (dividend off)..... | 131 $\frac{1}{2}$         |
| Manhattan.....               | 132                       |

## INSURANCE SHARES

|                                 |            |
|---------------------------------|------------|
| New York Insurance Company..... | 128 %      |
| Columbian.....                  | 137 a 138  |
| United.....                     | 118 a 119" |

(Pratt, p. 6.)

(IIIb) During the past century the Exchange has successively occupied the old Tontine Coffee House which stood at Wall and Water Streets (1817-27); the Merchants' Exchange Building formerly at Wall and Hanover Streets (1827-35 and 1842-54); a building at 43 Wall Street (1835-42); the old Corn Exchange Bank Building (1854-56); the Lord's Court Building at 25 William Street (1856-65); the old Stock Exchange Building on the present site at 10-12 Broad Street (1865-1901); the Produce Exchange Building (1901-03); and since 1903 the present Stock Exchange Building fronting on Broad, Wall, and New Streets. To this building an extensive twenty-two story addition fronting on Wall Street was begun in 1920, and completed in 1922.

In 1927 an additional wing to the Stock Exchange floor was opened down New Street to Exchange Place, while in 1928 more space southward from the old Stock Exchange floor was made available. In the latter year the Exchange also acquired all the property southward to Exchange place, thus coming to occupy the whole block bounded by Wall, Broad and New Streets and Exchange Place.

(IIIc) Under the Stock Exchange Constitution, an increase in the total Exchange membership must be approved by the Governing Committee and ratified by the existing membership. In 1926 the Governing Committee approved a plan for the creation of 25 new "seats," but this limited plan failed of ratification by the members. Meanwhile the volume of Exchange business grew rapidly, and the need of additional members on its floor for the adequate conduct of its collective business became increasingly apparent. On October 28,

1928, President E. H. H. Simmons again urged an enlarged membership, and subsequently a Special Committee of Governors devised the 25% plan which was adopted by the Governing Committee January 24, 1929, and was then ratified by vote of the existing Exchange membership and became effective February 7, 1929.

(IIId) Information as to the total amounts and values of securities listed on the New York Stock Exchange prior to January 1, 1925, can only be obtained from the unofficial quotation sheets issued daily by the publishing house of F. E. Fitch & Co., New York City.

On and after January 1, 1925, the Statistical Department of the Exchange has regularly computed the total nominal amount and market value of listed securities as of the beginning of each month; these statistics are made available as soon as completed by release to the press, and are summarized on an annual basis in each annual President's Report. For the first of each year, these official statistics have been as follows:

## BONDS

|                       | Par Value        | Market Value     |
|-----------------------|------------------|------------------|
| January 1, 1925.....  | \$34,445,534,672 | \$33,599,231,396 |
| January 1, 1926.....  | \$36,995,089,533 | \$35,509,211,458 |
| January 1, 1927.....  | \$37,900,053,650 | \$37,167,607,468 |
| January 1, 1928.....  | \$36,881,320,122 | \$36,874,717,458 |
| January 1, 1929*..... | \$48,588,549,854 | \$47,379,028,502 |
| January 1, 1930.....  | \$49,058,099,434 | \$46,892,458,780 |

## STOCKS

|                      | Number of Shares | Market Value     |
|----------------------|------------------|------------------|
| January 1, 1925..... | 433,293,513      | \$27,069,975,482 |
| January 1, 1926..... | 491,615,837      | \$34,489,227,125 |
| January 1, 1927..... | 585,641,222      | \$38,376,162,138 |
| January 1, 1928..... | 654,999,126      | \$49,736,350,946 |
| January 1, 1929..... | 757,301,677      | \$67,472,053,300 |
| January 1, 1930..... | 1,127,682,468    | \$64,707,878,131 |

\*Increase primarily due to listing of approximately \$12,000,000,000 British Government sterling war bonds.

These listing statistics are of course basic in any statistical consideration of Stock Exchange growth in respect to volume of sales, clearances, members' collateral borrowings, etc. They also furnish the most comprehensive available index numbers as to prices of securities listed on the New York Stock Exchange; such index numbers are obtained as of the first of each month for bonds, by dividing total par value into total market value, and for stocks by dividing total number of shares into their total market value. This index is of course "weighted" by the respective size of each listed issue—that is, a stock issue of 2,000,000 shares is twice as valent as one of 1,000,000 shares, etc. Owing to stock dividends, "split-ups," and similar changes in a

listed stock issue which may artificially increase its total number of listed shares without similarly increasing its aggregate market value, it has been necessary to "correct" this inclusive share index so that it may not minimize the average price appreciation which it may show.

The total number of issues listed on the New York Stock Exchange, at five-year periods since 1900, are given in the following tables:

## LISTED BOND ISSUES

| Year   | U. S.<br>Government | U. S., State,<br>County, & City | Foreign<br>Government | Railroad | Utility &<br>Industrial | Total |
|--------|---------------------|---------------------------------|-----------------------|----------|-------------------------|-------|
| 1900.. | 6                   | 69                              | 1                     | 637      | 82                      | 795   |
| 1905.. | 6                   | 64                              | 5                     | 722      | 110                     | 907   |
| 1910.. | 9                   | 63                              | 10                    | 776      | 165                     | 1,023 |
| 1915.. | 10                  | 72                              | 14                    | 749      | 151                     | 996   |
| 1920.. | 20                  | 78                              | 26                    | 709      | 283                     | 1,116 |
| 1925.. | 16                  | 66                              | 105                   | 729      | 417                     | 1,333 |
| 1930.. | 12                  | 53                              | 203                   | 675      | 600                     | 1,543 |

## LISTED SHARE ISSUES

| Year      | Banks &<br>Trust Cos. | Railroad | Industrial &<br>Miscellaneous | Total |
|-----------|-----------------------|----------|-------------------------------|-------|
| 1900..... | 70                    | 177      | 115                           | 362   |
| 1905..... | 55                    | 178      | 138                           | 371   |
| 1910..... | 53                    | 175      | 198                           | 426   |
| 1915..... | 41                    | 177      | 298                           | 516   |
| 1920..... | 34                    | 173      | 475                           | 682   |
| 1925..... | 23                    | 163      | 740                           | 926   |
| 1930..... | 6                     | 160      | 1,127                         | 1,293 |

(IIIe) The stock posts on the floor of the Exchange have themselves been subject to a process of evolution, particularly in the past decade. Until 1929 they were posts of substantial size and height, with a number at the top, price-recording dials and price sheets on the sides, and a circular seat at the base for specialists and other members; a tube station was attached to each post. The rapid increase in share listings and dealings during 1925-28 rendered desirable some system for segregating the markets for particular share issues which would be more economical of floor space. The Committee of Arrangements devised the present new style of stock post, each of which can accommodate over 100 different stock issues, as against only about 25 for the former posts. The 20 old posts were accordingly replaced in 1928-29 by 12 of the new posts on the main Exchange floor.

The new type of trading post is U-shaped, and permits about twelve clerks to be stationed inside. This allows Exchange members, and particularly specialists, to enjoy telephone communication and clerical assistance immediately at the stock posts—most useful facilities pre-



viously impossible. Tube stations are connected with the new as with the old type of post.

(III f) In the New York Stock Exchange quarters in 1928 there were 2,114 telephones, of which 1,615 were members' private wires to the floor. On these latter approximately 1,500,000 calls were transmitted each five-hour day. Between 1,050 and 1,100 members' telephone clerks were engaged on the floor in handling orders. Exclusive of wires strung for the service of tenants, approximately 70,000 miles of telephone and telegraph wires were used in the Exchange building.

(III g) Telephone booths on the Exchange are connected with the stock posts by a pneumatic tube system containing 35 miles of aluminum tubing which runs beneath the floor, and six 75-horsepower compressors delivering 30,000 cubic feet of air per minute at  $1\frac{1}{2}$  pounds pressure.

From a chemical standpoint, at any rate, the atmosphere on the floor is singularly pure and invigorating. The Exchange has long employed a refrigerating system for cooling and filtering the air in its building; on especially humid days as much as four gallons of water a minute have been extracted from the atmosphere. Recently, to further purify the air on its floor, the Exchange also installed a fourteen tube ozone machine capable of delivering 210 ventilating units.

(III h) On special occasions, eminent American and foreign visitors, and also partners of Stock Exchange members, have been admitted on the floor with an escort during business hours. Further, under prescribed conditions (see Constitution, Article XII, Sec. 7), the partner of the President of the Exchange, though not an Exchange member, may exercise the privilege of transacting business on the floor for the account of the firm of which the President is a member. This privilege may not, however, be exercised by such a partner while the President himself is engaged in the transaction of business on the floor of the Exchange. A like privilege may also be extended to a partner of the Vice-President of the Exchange, the Chairman of the Committee of Arrangements, the Chairman of the Committee on Business Conduct, and the President of the New York Stock Exchange Building Company. Stock Exchange employees are permitted on the floor in uniform. As for employees of Stock Exchange members, telephone clerks are permitted in the members' telephone booths and specialists' clerks inside the new hollow stock posts; neither of these places, however, is technically a part of the Exchange trading floor.

(III i) An active Personnel Department, under the direction of the Committee of Arrangements, supervises the work of the younger Ex-

change employees and assists them in improving their business status, and continuing their education. For the latter purpose the Department organized the "New York Stock Exchange Institute" which regularly conducts lectures and class-room exercises in finance, economics, and related subjects for the benefit of Exchange employees. The Department also maintains an employment office through which not only the Exchange but also its members can secure employees. Frequently Exchange firms recruit their office forces from young men trained in this way in the service of the Stock Exchange itself. The intensely human and progressive policy carried out by the Personnel Department would deserve extensive comment in any but an economic study of the Exchange system like the present; special information concerning the Department's work can, however, be readily obtained from its annual reports, copies of which can be secured from it upon application.

## CHAPTER IV

### The Distribution of Securities

(IVa) Owing to the comprehensive and searching analysis of new security issues applying for listing made by the Committee on Stock List, fraudulent security promoters always give the New York Stock Exchange a wide berth. Naturally, the Exchange has no contact with or responsibility for the security swindling by "fly-by-night" promoters which occurs sporadically all over the country, and especially perhaps in centers far from New York. Nevertheless such swindles seriously injure the legitimate security business, and in any case the Exchange has not wished to play the Pharisee in regard to so iniquitous and harmful an evil.

In 1922 the New York Stock Exchange played the principal part in financing the establishment of the Better Business Bureau of New York, as a permanent fraud-detecting and fraud-fighting agency. In 1924, Mr. E. H. H. Simmons, President of the New York Stock Exchange, inaugurated a national campaign against security swindling, which was endorsed by President Coolidge. The cooperation of the Federal Government in Washington (especially through the Inspectors of the U. S. Post Office Department), of the Securities Commissioners of the various States of the Union, of local prosecuting officials, and of Stock Exchange firms, banks, and other private financial firms, was obtained. In addition, the Exchange established a Fraud Bureau in its own organization, to cooperate with other parties interested in suppressing frauds by exchanging information and striving to obtain

concerted action. The whole movement, which has undoubtedly accomplished valuable results already, owes much to Mr. Simmons, who not only initiated it but who has subsequently made addresses in many parts of the United States and abroad in connection with it.

(IVb) It must be realized that the American security underwriting and flotation business has grown up under sometimes unique economic and legal conditions, and that in method and organization it differs considerably from the practices of foreign financial centers. In London, for example, underwriting and issuing securities are looked upon as distinctly separate operations, and frequently a new flotation will be underwritten by one firm or group and issued by another. In America, it is almost always the same firm or syndicate which underwrites and issues. Also, the practice of issuing to secondary "subsyndicates" is largely peculiar to this country.

In general, European underwriting and issuing technique evolved during the last century when the leading European countries were creditor nations. Our business, however, was inevitably influenced by the fact that through the same formative period the United States was a debtor nation, where capital was almost regularly more scarce than legitimate domestic securities. Thus, the emphasis abroad was upon obtaining new securities to issue, while with us it was upon obtaining capital. This is perhaps the basic reason why direct security selling by bond-salesmen has always been a unique American practice. It is interesting to conjecture just what differences to our underwriting and issuing practice our present status as a creditor nation is likely to produce. It may be that more and more the United States will have to adapt its practice to the condition of a regular surplus of capital. The description of American security underwriting and issuing methods in this chapter must therefore be considered as traditional but not necessarily immutable, and notably different from orthodox European methods.

(IVc) The origin of the New York Curb Market is obscure, but it first attained permanent size and significance during Civil War times. For many years it used to meet in the middle of Broad Street a little south of Exchange Place. Being an open-air market, it lacked administrative discipline, dependable quotations, or limitations as to the character either of its members or of the securities in which it dealt. Although basically a useful market, it gained a general reputation of "caveat emptor."

In 1921 the leading firms with representatives on the Curb organized an association modeled in general after that of the New York

Stock Exchange, purchased property in Trinity Place, erected an exchange building there, and thus transformed itself into an organized stock exchange. Its volume of activity has been second among American stock exchanges only to the New York Stock Exchange. Its indoor status has permitted the adoption and enforcement of disciplinary rules, and its evolution as an organized market has thus been assured. Naturally, the character of dealings upon it has been sensationally improved, as compared with "the old days in Broad Street."

The Constitution of the New York Stock Exchange forbids its members or firms to be members of, or to have membership in, any other stock exchange in New York City which deals in the same securities as the New York Stock Exchange. By a mutual understanding between the Exchange and the Curb, the latter market ceases to trade in any issue as soon as it is listed upon the former.

(IVd) Specifically these documents consist of (1) a memorandum in regard to copies of corporate papers, etc., required for the files of the Exchange; (2) the requirements themselves, with special supplementary requirements for (3) foreign internal shares and (4) investment trust securities; (5) a questionnaire to be signed by an officer of the applicant company; (6) a formal resolution by the corporation to apply for listing; (7) special agreements to be entered into between the applicant and the New York Stock Exchange; and distribution statements for (8) bond and (9) shares issues.

The aforesaid memorandum summarizes the various details required by the Committee on Stock List, as follows:

**Memo. for.....Company**

**Preliminary:**

- Four drafts of application.
- One copy, Charters, By-Laws, Mortgages, etc.
- One distribution.
- Set of specimens.

*The following papers, etc., are required to complete the files:*

Check for \$.....and letter of transmittal to accompany application.

- 1 Application, original signed copy (and 12 copies).
  - " sign proof.
  - " final signed copy.
- 2 Charter, with amendments (certified by Secretary of State), (and 3 copies).
- 3 By-Laws, with amendments (certified); (and 3 copies).
- 4 Leases (locations).
- 5 Special Agreements.

- 6 Resolutions :
  - a. Authorizing issues—stockholders.
  - b. “ “ —directors.
  - c. “ reservation for conversion.
  - d. “ listing—appearance of.....
  - e. Appointing transfer agents and registrars.
- 7 Registrar's certificates as to amount registered.
- 8 Opinion of counsel.
- 9 Distribution (and 7 copies), all signed.
- 9a Notice from Transfer Agent as to amount issued.
- 10 Public authority certificate.
- 11 Report of engineer (or equivalent).
- 12 Map.
- 13 Specimens (temporary) approved.....
- 14 “ (permanent) approved.....
- 15 “ (altered) approved.....
- 16 Mortgage or indenture (and supplements) (certified) (and 3 copies).
- 17 Trustee's certificate, showing: (a) acceptance of trust; (b) securities are issued in accordance with indenture; (c) disposition of securities redeemed or refunded; (d) collateral deposited; (e) disposition of prior obligations.
- 18 Certified copy of release or satisfaction of underlying mortgages.
- 19 Financial statements (certified).
- 20 Questionnaire.
- 21 Notice of availability of eligible security for trading (issue, transfers and exchanges).
- Notice from Company as to amount taken by underwriters.
- 22 Agreements.
  - Certificates of Deposit, Voting Trust, etc.
    - Certified copy deposit or trust agreement.
    - Certified copy circular issued by trustees or committee.
    - Certificate as to amounts deposited.
- Reorganizations :
  - Certified copy decree of foreclosure or dissolution.
  - Certified copy decree confirming sale.
  - Certified copy of court, authority for reorganization.
  - Certified copy of plan.

### (IVE) The Requirements

The Committee will meet Mondays at 3:15 P. M.

An application, conforming to these requirements, signed by an executive officer of the applying corporation, voting trustees, or depositary committees, and nine printed or typewritten copies must be filed with the Secretary of the Exchange at least five days prior to date set for consideration.

Applications must be accompanied by the required papers and agreements and by a check to be drawn to the order of "Treasurer, New York Stock Exchange" for a fee in accordance with the following schedule, such fee being computed separately for each class of security included in an application. In addition to such fees, companies making application are required to pay cost of printing. Printer's bills will be submitted directly to the applicant.



## BASIC FEES

The basic fee for listing stock or securities arising out of stock, such as Certificates of Deposit for stock, Interim Certificates for Stock, Allotment Certificates for Stock, Voting Trust Certificates, etc., shall be, in the case of certificates having either no par value or a par value of \$100 or less, one and two-tenths cents (1.2¢) per share, any fraction of ten thousand (10,000) shares, over and above a multiple thereof, to be counted as ten thousand shares for this purpose. The basic fee for listing bonds, debentures, notes and similar instruments having a face value and not being issued in denominations of less than \$100 shall be one hundred and twenty dollars (\$120) per million dollars (\$1,000,000) face value or fraction thereof.

In any case, where a fee is to be charged, whether at the basic rate or at a modified rate, the minimum fee will be \$120.

The full basic fee will be charged in all cases, unless otherwise herein stated.

## MODIFICATIONS OF BASIC FEES

1. In cases where, after an initial listing, a change is involved between par and no par in either direction, or is in the amount of the par value of the security, or represents a greater or smaller number of shares of no-par stock involving the cessation of trading in no-par stock theretofore listed (as distinguished from a stock dividend in which the old stock continues to be traded in): the fee for such number of the substituted shares to be listed as is not in excess of the number of shares to be stricken from the list shall be one-fourth of the basic fee. For all shares, so issued, in excess of the number of shares to be stricken from the list, the full basic fee will be charged.

2. Where there is a change in the classification or name of a stock, without alteration of any preferences which it may bear, such as from Capital to Common, or vice versa, and without alteration in the number of shares, one-fourth of the basic fee will be charged. When, however, the change of name of a stock having a preference involves also the giving of a higher or lower preference to the stock, the full basic fee will be charged.

3. Where the change is in the nature of an extension of a time limit, as in the case of an extended voting trust, the number of shares listed not being increased, one-fourth of the basic fee will be charged.

4. Where the change is from *listed* stocks or bonds to Certificates of Deposit, whether or not a reorganization of the listed company is involved, one-fourth of the basic fee will be charged.

5. When the change is from Certificates of Deposit to stock or bonds:

(a) If such stock or bonds are identical with formerly listed securities, for which such certificates of deposit were issued, no fee will be charged up to the number of shares so formerly listed. For additional shares, the full basic fee will be charged.

(b) Where the certificates of deposit have been listed first and are thereafter replaced by the securities initially deposited, one fourth of the basic fee will be charged for listing such securities.

(c) If such stock or bonds represent securities issued under a reorganization, or in any other respect differ from the securities for which such

Certificates of Deposit were originally issued, the full basic fee will be charged, whether or not the securities were listed for which the Certificates of Deposit were originally issued.

6. Where voting trust or stock trust certificates are issued in exchange for listed stock of the same company, one-fourth of the basic fee will be charged.

7. When voting trusts or stock trusts terminate and where the stock replacing them is identical with formerly listed stock for which such voting or stock trust certificates were issued, there will be no fee up to the number of shares so formerly listed. For additional shares, the full basic fee will be charged. If, however, the stock replacing such certificates was not formerly listed, one-fourth the basic fee will be charged.

8. Where the name of a corporation is changed, without reorganization, merger, or other change in its corporate structure, the fee will be one-fourth of the basic fee for such number of shares as may be issued not in excess of the number of each class authorized to be listed prior to such change of name, plus the full basic fee for any additional number of shares. If, however, a reorganization or merger resulting in a new corporation is involved, the full basic fee will be charged on all shares to be listed.

9. In the case of a stock dividend, the additional stock issued is subject to the full basic fee. There is no additional fee as to the old stock.

An application for listing Governmental, State, County, or Municipal Securities must be signed by a properly accredited official or by financial representatives, and be accompanied by required check, as above, and papers.

Specimen application furnished on request.

THE EMPLOYEES OF THE COMMITTEE ON STOCK LIST ARE INSTRUCTED TO ASSIST IN THE PREPARATION OF APPLICATIONS TO LIST WHENEVER SO REQUESTED. NO CHARGE WILL BE MADE FOR SUCH SERVICE.

## REQUIREMENTS FOR ORIGINAL LISTING

### Stock

Every application for an original listing of capital stock shall recite:

*A* Where incorporated.

*B* (1) Amount applied for (whether temporary or permanent certificates); (2) authorized issue.

*C* (1) Date of charter; (2) duration.

*D* (1) Business; (2) special rights or privileges under charter or by-laws.

*E* (1) Whether capital stock is full paid; (2) non-assessable; and (3) whether liability attaches to shareholders.

*F* (1) Issues (by classes), dividend rate, and par value; (2) total amount of each, authorized and issued; (3) increases and authority therefor, including (a) action by stockholders, (b) by directors, and (c) by public authorities, etc.; (4) amount unissued, (a) options or contracts on same, (b) specific reservation for conversion.

*G* If preferred stock; (1) whether cumulative or non-cumulative; (2) preferences, including (a) voting power; (b) dividends; (c) distribution of assets on dissolution or merger; (d) redemption; (e) convertibility; (f) special provisions.

*H* Voting power of obligations of debt.

*I* (1) Purpose of issue; (2) application of proceeds; (3) amount issued for securities, contracts, property; description and disposition; (4) additional property to be acquired, with particulars, as required by paragraph *N*.

*J* (1) History of corporation; (2) of predecessor companies or firms, with (a) location and stock issues (by classes); (b) conditions leading to new organization.

*K* Tabulated list of constituent, subsidiary, owned or controlled companies showing (a) date of organization; (b) where incorporated; (c) duration of charter; (d) business and (e) capital stock issues (by classes), par value, amount authorized, issued, owned by parent company.

*L* (1) Mortgage, and (2) other indebtedness showing (a) date, (b) maturity, (c) interest rate, (d) convertibility, (e) redemption by sinking fund or otherwise, (f) amount authorized, and (g) amount issued; (3) similar information regarding mortgage and other indebtedness of constituent, subsidiary, owned, or controlled companies.

*M* Other liabilities, joint and several, (1) guaranties, (2) leases, (3) traffic agreements, (4) trackage agreements, (5) rentals, (6) car trusts, etc., (7) terms of each, and provision for payment; (8) similar description of other agreements or easements; (9) similar information as to constituent, subsidiary, owned or controlled companies.

*N* (1) Description, location, nature, and acreage of property, (a) owned in fee; (b) controlled; (c) leased; (2) railroads, mileage completed, operated, and contemplated; (3) equipment; (4) character of buildings and construction; (5) tabulated list of franchises showing (a) where granted, (b) date, (c) duration, (d) purpose; (6) timber, fuel, or mining lands, water rights; (7) similar information as to constituent, subsidiary, owned, or controlled companies.

*O* Policy as to depreciation.

*P* (1) Character and amount of annual output for preceding five years; (2) estimated output (character and amount) for current year; (3) number of employees.

*Q* (1) Dividends paid or declared; (2) by predecessor, and constituent, subsidiary, owned, or controlled companies.

*R* Financial statements; (1) earnings for preceding five years, if available with interest charges, depreciation, and federal taxes; (2) income and surplus account of recent date for at least two years, if available; (3) balance sheets of same dates; (4) balance sheet giving effect to recent financing, if any; (5) similar accountings for predecessor, constituent, subsidiary, owned or controlled companies; (6) corporation consolidated within one year previous to date of application, income and surplus account and balance sheet of all companies merged and balance sheet of applying corporation; (7) if in hands of receiver within one year previous to date of application, (a) income account and balance sheet of receiver at time of discharge if available, (b) balance sheet at close of receivership if available, and (c) balance sheet at date of reorganization.

*S* Agreements contained on pages 5 and 6.

*T* Fiscal year.

*U* Place and date of annual meeting.

*V* Location of principal and other offices.

*W* Names of (1) directors, classified, with addresses; (2) officers; (3) transfer agents, with addresses; (4) registrars, with addresses.

*In addition to the above, applications from corporations which own or operate mines must recite:*

*A* Patented and unpatented claims, by numbers.

*B* (1) Geological description of country; (2) location and description of mineral and other lands; (3) ore bodies; (4) average value of ore; (5) character and analysis; and (6) methods of treatment.

*C* History of workings, (1) results obtained; (2) production each year.

*D* (1) Ore reserves compared with previous years showing separately as to character and metal content; (2) estimate of engineer as to probable life of mines; (3) probabilities by further exploration.

*E* (1) Provisions for smelting and concentration; (2) proximity of property to railway or other common carrier.

*F* Properties in process of development; income account if available; guaranties for working capital and for completion of development in event income account not available.

*G* Total expenditures for preceding five years for acquisition of new property, development, proportion charged to operations each year.

*H* (1) Policy as to depletion; (2) acquisition of new property; (3) new construction and development.

*I* Production by tons, number of tons of ore treated, average assay yield, percentage of extraction, recovery per ton of ore, for preceding five years, if available.

*In addition to the above, applications from corporations which own or operate oil and gas wells must recite:*

*A* (1) Brief history of oil field; (2) geological description of country; (3) character and gravity of oil.

*B* (1) Total area of oil land (developed and undeveloped), (a) owned, (b) leased, (c) controlled, (d) proven, (e) under exploitation, (f) royalties.

*C* (1) Number of wells (oil or gas) on each property, (a) in operation, (b) drilling, (c) contemplated; (2) average depth of wells drilled, (a) shallowest, (b) deepest, (c) probable life; (3) whether oil sands are dipping.

*D* (1) Gross daily production—initial and present; (2) annual gross production from each property for preceding five years, if available; (3) estimated gross production for current year.

*E* (1) Storage, capacity and location; (2) (a) amount of oil stored, (b) character, (c) value; (3) pipe line, (a) gauge, (b) capacity, (c) mileage.

*F* (1) Refineries, (a) capacity, (b) acreage, (c) employees, (d) products and by-products.

*G* Properties in process of development; income account if available; guaranties for working capital and for completion of development in event income account not available.

*H* Total expenditures for preceding five years for acquisition of new property, well drilling and development, proportion charged to operations each year.

*I* (1) Policy as to depletion; (2) acquisition; and (3) development of new properties.

### Bonds

An application for an original listing of bonds shall recite all information required for listing stock, and



*A* (1) Full title; (2) amount applied for (whether temporary or permanent), denominations and numbers; (3) amount authorized and outstanding, authority therefor, including (a) action by stockholders, (b) directors; and (c) public authorities, etc.; (4) whether bonds are coupon (registerable as to principal) or registered, interchangeable or exchangeable; (5) exchangeability or convertibility into other securities and terms.

*B* Names and addresses of trustees.

*C* (1) Date of issue and maturity; (2) interest rate; (3) places at, and dates for payment of interest and principal; (4) where registerable or transferable; (5) kind and standard of money, and options; (6) tax exemptions; (7) whether redeemable or purchasable in whole or part by sinking fund or otherwise, showing (a) dates (b) price, (c) duration and place of published notice; (8) specified reservation of stock for conversion.

*D* Provisions for declaration of principal due and payable in event of default of payment or interest, or other defaults, and waiver; percentage of outstanding bonds controlling trustee.

*The Committee will object to any provision in an Indenture whereby the consent of more than 30% of the outstanding bonds is necessary to initiate any action by the Trustees which may appear necessary for the protection of bondholders, subject, however, to the limitation that there is no objection to a provision by which the action of a majority in amount of such bonds will rescind any minority action.*

*E* Purpose of issue and application of proceeds, similar to that called for by Paragraph *I* of the Requirements for Listing Stock; provisions as to additional issue.

*F* Disposition of bonds refunded, redeemed, or purchased for sinking fund, and mortgage securing same.

*G* Mortgage or indenture provisions for (1) serial issues; (2) values in United States gold coin; (3) issuance in foreign languages and (4) that the English version governs; (5) terms of exchangeability of bonds payable in foreign places for bonds payable in United States or vice versa.

*H* (1) Security—Mortgage, indenture of trust, or other agreement; and (2) liens, (a) properties covered, (b) mileage of railway lines, (c) buildings, (d) equipment, (e) securities, (f) rights, (g) privileges, (h) titles, (i) franchises, (j) leases, etc.; (3) other liens covering same or any part of same properties; (4) guaranty and terms.

*I* Any unusual provisions or covenants contained in mortgage, or deed of trust.

#### REQUIREMENTS FOR LISTING OF ADDITIONAL AMOUNTS

Refer to previous applications and last application by number and date, and recite:

*A* Where incorporated.

*B* (1) Amount applied for; (2) amounts authorized and outstanding; (3) authority for issue, including (a) action by stockholders, (b) by directors, and (c) by public authorities, etc.; (4) total amount applied for.

*C* (1) Purposes of issues; (2) application of proceeds; (3) amount, description and disposition of securities exchanged for new issues; (4) additional property acquired or to be acquired, with particulars as required by Paragraph *N* on page 2.

*D* Dividends paid and declared since previous application.



*E* Changes, if any, in (1) charter; (2) by-laws; or (3) capitalization since previous application.

*F* Changes in property, if any, since previous application.

*G* (1) Character and amount of output since previous application or earnings as in application for original listing; (2) estimated output (character and amount) for current year; (3) number of employees.

*H* Income account, surplus account and balance sheet of recent date, also for constituent, subsidiary, owned or controlled companies, or a consolidated income account, consolidated surplus account and a consolidated balance sheet.

*I* Policy as to depreciation and depletion.

*J* Fiscal year, place and date of annual meeting, location of offices, and names of officials as covered by Paragraphs *T*, *U*, *V* and *W* on page 2.

(Note: "When a corporation purposes to increase its authorized capital stock, thirty days' notice of such proposed increase must be officially given to the Exchange before such increase may be admitted to dealings.")

(Note: "When the capital stock of a corporation is increased through conversion of convertible bonds already listed, the issuing corporation shall give immediate notice to the Exchange and the Committee on Stock List may, thereupon, authorize the registration of such shares and add them to the list.")

#### REQUIREMENTS FOR LISTING OF CERTIFICATES OF DEPOSIT, VOTING TRUST OR STOCK TRUST CERTIFICATES, ETC.

Every application for the listing of certificates of deposit, voting trust or stock trust certificates, etc., shall recite:

*A* (1) Name of applicant; (2) amount applied for (whether temporary or permanent certificates); (3) depository; (4) security deposited, and whether listed; (5) registrar.

*B* (1) Date of agreement; (2) names of committee, or voting trustees; (3) terms of trust; (4) powers and duties of committee, trustees, or depository.

*C* Reasons for deposit.

*D* (1) Duration of trust or deposit; (2) extensions or limitations; (3) final date of deposits; (4) provision for deposits without penalty for approximately thirty days after listing, or if no time limit for deposit of securities without penalty is fixed, an agreement that approximately thirty days' notice of such limitation of time shall be published and given to the Stock Exchange; (5) date of presentation of plan; (6) provisions for dissent and withdrawal; (7) percentage necessary to adoption; (8) pro rata, charges; (9) provisions for return of securities (or equivalent); (10) provision for payment of interest dividends, etc.

*E* Applications to list Voting Trust or Stock Trust Certificates to recite financial statements of company as in Paragraph *R* on page 2.

*F* Agreement to deliver definitive securities at termination of Voting Trust or Voting Trust to be extended.

*G* Agreement to have definitive securities listed.

*H* Agreement by Voting Trustees to have company publish its financial statements.

*I* Agreements contained on pages 5 and 6.

(Note: Applications to list voting trust or stock trust certificates and certificates of deposit for securities not a delivery on the Stock Exchange must, in addition, comply with the Requirements.)

Applications for each class of deposited securities shall be separate and certificates issued of distinctive colors.

#### PAPERS TO BE FILED WITH APPLICATIONS

In addition to application for listing, the following papers must be filed:

##### FOR STOCKS:

1 Three copies of charter, with amendments to date, one copy attested by proper public authority.

2 Three copies of by-laws, with amendments to date, one copy attested by an executive officer of corporation.

3 Three copies of leases, franchises, easements and special agreements, one copy of each attested by an executive officer of corporation.

4 One copy of resolutions of stockholders and directors and copy of proper public authority authorizing issue, each attested by an executive officer of corporation.

5 One copy of resolutions of stockholders or directors, and copy of proper public authority, authorizing issue of stock on conversion or other securities, attested by an executive officer of corporation.

6 One copy of resolutions of stockholders or directors directing specific reservation of authorized stock for conversion attested by an executive officer of corporation.

7 One copy of resolutions of stockholders, board of directors, or executive committee attested by an executive officer of corporation, authorizing, by name, official to appear for listing securities (form may be had on application).

8 Opinion of counsel (not an officer or director of the corporation) as to legality of (a) organization, (b) authorization, (c) issue, and (d) validity of securities. *The Committee will not accept the opinion of an officer or director of an applying corporation nor of a firm in which the officer or director is a member, as counsel on any legal question affecting the corporation; nor will it accept the opinion of an officer or director of a guarantor corporation nor of a firm in which the officer or director is a member, on any legal question affecting the issuance of guaranteed securities.*

9 Six copies of detailed distribution of securities, one certified (form may be had on application).

10 One copy of resolution appointing transfer agent and registrar, attested by an executive officer of corporation.

11 Certificate of registrar of amount of securities registered at date of application.

12 Report of qualified engineer covering actual physical condition of property at recent date.

13 Map of property and contemplated extensions.

14 Specimens of all securities to be listed.

15 Questionnaire (form may be had on application).

16 Certified copy of income accounts, surplus accounts and balance sheets contained in application.

17 Agreements.

18 Certified copy of printed circular issued by Bankers describing security, if available.

## FOR BONDS:

19 All papers required for listing stocks and also ten copies of the mortgage or indenture, one copy (a) certified to by trustee, (b) with copies of all certificates of proper recording.

20 Trustees' certificate required on page 6.

21 One copy of resolutions of stockholders or directors, and copy of proper public authority, authorizing issue of stock on conversion of bonds, attested by an executive officer of corporation.

22 One copy of resolution of stockholders or directors directing specific reservation of authorized stock for conversion, attested by an executive officer of corporation.

23 Certificate of disposition of securities redeemed or refunded.

24 Certificate as to collateral deposited.

25 Certified copy of release or satisfaction of underlying mortgages.

## FOR SECURITIES OF REORGANIZED CORPORATIONS:

1 All papers required for listing stocks and bonds. *Opinion of counsel shall state that proceedings have been in conformity with legal requirements, that title to property is vested in new corporation and is free and clear from all liens and incumbrances, except as distinctly specified; and also as to equities of securities of predecessor corporation.*

2 Certified order of court confirming sale on foreclosure or other authority for reorganization.

3 Certified copy of plan of reorganization.

4 Certified income and surplus account and balance sheet at close of receivership, if available.

5 Certified balance sheet at date of reorganization.

## FOR ADDITIONAL AMOUNTS:

1 Nos. 4, 5, 6, 7, 8, 9, 11, 15, 16, 17, 18 of papers required for original listings.

2 Nos. 1, 2, 3, 10, 12, 14 of said papers for stock, *if any changes have occurred therein since previous application.*

3 Nos. 1, 2, 3, 12, 14, 20, 21, 22, 23, 24, 25 of said papers for bonds, *if any changes have occurred therein since previous application.*

4 Certified copy of proper public authority for increase.

## FOR CERTIFICATES OF DEPOSIT, VOTING TRUST, ETC.:

1 Papers required for listing stocks and bonds.

2 Certified copies of any legal proceedings and court orders.

3 Three copies of deposit or trust agreement, one certified to by proper authority.

4 Three copies of circulars, issued by trustees or committee, one certified to by proper authority.

5 Certificates of amounts deposited.

## AGREEMENTS

To be made part of applications where applicable:

1. To notify the New York Stock Exchange promptly of any change in the general character or nature of its business.

2. To notify the New York Stock Exchange immediately if it or any subsidiary or controlled company should dispose of any property or of any stock interest in any of its subsidiary or controlled companies, when such

disposal would impair or materially affect its financial position or the nature or extent of its operations as theretofore conducted.

3. To publish periodical statements of earnings, as agreed upon with the Committee.

4. To publish at least once in each year and submit to stockholders at least fifteen days in advance of the annual meeting of the corporation, a Balance Sheet, an Income Statement for the last fiscal year and a Surplus statement of the applicant company as a separate corporate entity and of each corporation in which it holds directly or indirectly a majority of the voting stock; or, in lieu thereof, eliminating all intercompany transactions:

(a) a similar set of financial statements fully consolidated as to the applicant company and all corporations in which it owns directly or indirectly a majority of the voting stock, or

(b) a similar set of financial statements consolidated as to the applicant company and specifically named or described subsidiaries, with separate similar financial statements for each unconsolidated corporation in which the applicant company holds directly or indirectly a majority of the voting stock.

Such statements shall disclose fully the nature and extent of the interest of the applicant company in the corporations whose unconsolidated financial statements are furnished, and also the existence of any default in interest, cumulative dividend requirements or sinking fund or redemption fund requirements of any of the corporations whose accounts are thus consolidated or separately shown.

5. To publish all future annual financial statements of any character, in the form contained in the listing application and, in the publication of reports of earnings for any period of less than a fiscal year, to show net profits in the aggregate and per share after Depreciation, Depletion, Income Taxes and Interest, estimating the proportionate amount of these items as accurately as may be if not finally determined at date of publication.

6. Not itself, and not to permit any subsidiary, directly or indirectly controlled, to take up as Income stock dividends received at an amount greater than that charged against Earnings, Earned Surplus or both of them by the issuing Company in relation thereto.

7. To maintain, in accordance with the rules of the Stock Exchange, a transfer office or agency in the Borough of Manhattan, City of New York, where all listed securities shall be directly transferable, and the principal of all listed securities with interest or dividends thereon shall be payable; also a registry office in the Borough of Manhattan, City of New York, south of Chambers Street, other than its transfer office or agency in said city, where all listed securities shall be registered. If its transfer books should be permanently closed, to continue to split up certificates of listed stock into smaller denominations in the same name so long as such stock shall be retained upon its list by the New York Stock Exchange. If its transfer office or agency should be or should become located north of Chambers Street, to arrange, at its own cost and expense that its registry office will receive and re-deliver all securities deposited at such registry office for the purpose of transfer.

8. To notify the Stock Exchange thirty days in advance of the effective date of any change in the authorized amounts of listed securities.

9. Not to add to the number of its transfer agencies, nor to make any change of a transfer agency or of a trustee of its bonds or other securities



without prior notice to the Committee on Stock List, and not to make any change in its listed securities, nor to add to the number of the registrars of its stock, nor to change a registrar of its stock, without the prior approval of the Committee on Stock List; nor to select an officer or director of the company as a trustee of its mortgages or other listed securities, unless such officer or director be a co-trustee for an issue having a corporate trustee.

10. To notify the Stock Exchange in the event of the issuance or creation in any form or manner of any rights to subscribe to, or to be allotted, its securities, or of any other rights or benefits pertaining to ownership in its securities, and to afford the holders of its listed securities a proper period within which to record their interests and to exercise their rights, and to issue all such rights in form approved by the Stock Exchange and to make the same transferable, payable and deliverable in the Borough of Manhattan, City of New York.

11. To notify the Stock Exchange promptly in the event of issuance of Options or Warrants to purchase stock, otherwise than pro rata to stockholders, or the number of shares covered by such Options, of their terms and of the time within which they may be exercised and of any subsequent changes therein and thereafter to include this information together with like information as to any Options in existence at the time of approval of this application so long as said Options are outstanding, in all annual financial reports furnished to stockholders and in all formal published reports.

12. To make application to the Stock Exchange for the listing of additional amounts of listed securities sufficiently prior to the issuance thereof to permit action in due course upon such application.

13. To publish promptly to holders of stock any action in respect to dividend on shares, or allotments of rights for subscription to securities, notices thereof to be sent to the Stock Exchange, and to give to the Stock Exchange at least ten days' notice in advance of the closing of the transfer books, or extensions, or of the taking of a record of holders for any purpose.

14. To forward to the Stock Exchange copies of all notices mailed to stockholders looking toward Charter amendments, and to file with the Stock Exchange a certified copy of amended Charter, or Resolutions of Directors in the nature of amendments, as soon as such amendments or resolutions have become effective.

15. Not to purchase preferred stock for redemption except in the open market and not to select preferred stock for redemption otherwise than pro rata or by lot; to notify the Stock Exchange immediately and at least fifteen (15) days in advance of any such redemption, and to furnish to the Stock Exchange any information requested in reference to such redemption.

16. To notify the Stock Exchange of the change or removal, to a substantial extent, of collateral deposited under any of its mortgage or trust indentures under which listed securities are outstanding.

17. To have on hand at all times a sufficient supply of certificates to meet the demands for transfer.

18. If at any time the stock certificates of the company do not recite the preference of all classes of stock the company agrees with the Exchange that it will furnish stockholders, upon request and without charge, with a printed copy of the preferences of all classes of stock.



19. To furnish the New York Stock Exchange, on demand, such reasonable information concerning the company as may be required.

By .....

*The Committee recommends a date be fixed as record for dividends, allotment of rights and stockholders' meetings, without closing the transfer books.*

*Notice of rights, allotments, subscription privileges, to bondholders and shareholders, should be as of a date after authorization.*

### TRUSTEES OF MORTGAGES

The Committee recommends that a trust company or other financial corporation be appointed trustee of mortgages, indentures, and deeds of trust; and when a State law requires the appointment of an individual as trustee, a trust company or other financial corporation be appointed as co-trustee.

Each mortgage, indenture, or deed of trust should be represented by a separate trustee.

The Committee will not accept as trustee:

(a) An officer or director of the issuing corporation;

(b) A corporation in which an officer of the issuing corporation is an executive officer.

The trustee shall present a certificate accepting the trust and certifying (1) securities are issued under the terms of the mortgage or indenture, giving the numbers, denominations and amount authenticated; (2) collateral deposited; (3) disposition of prior obligations. For additional issues of bonds, the trustee must certify that (1) increase is in conformity with terms of mortgage or indenture, giving numbers, denominations and amount authenticated; (2) additional collateral deposited; and (3) disposition of prior obligations.

The company and trustee shall notify the Stock Exchange of the holding, cancellation, or retirement of securities, by redemption, through the operation of sinking fund or otherwise.

The trustee must notify the Stock Exchange if deposited collateral is changed or removed, and furnish a list of collateral substituted.

A change of trustee shall not be made without the approval of the Committee.

### TRANSFER AND REGISTRY

Every corporation whose securities are listed upon the Stock Exchange must, in accordance with the rules of the Exchange, maintain (a) a transfer office and (b) a registry office, both in the Borough of Manhattan, City of New York. The transfer agency and registrar *shall not be identical*, and both must be acceptable to the Committee. A company cannot act as registrar of its own stock.

Where a stock is transferred at the company's office, the transfer agent or transfer clerk shall be appointed by specific authority of the board of directors to *countersign* certificates, in said capacity, and shall be other than an officer who is authorized to sign certificates of stock.

The entire amount of the capital stock of a corporation listed upon the Stock Exchange *must be directly transferable* at the transfer office of the corporation in the Borough of Manhattan, City of New York. When a corporation makes transfer of its shares in other cities, certificates shall be

interchangeably transferable, and *identical in color and form*, except as to names of transfer agent and registrar; and the combined amounts of stocks registered in all cities shall not exceed the amount authorized to be listed.

Interchangeable certificates must bear a legend reciting the right of transfer in New York and other cities.

The registrar must file with the Secretary of the Stock Exchange an agreement to comply with the requirements in regard to registration and *not to register any listed stock, or any increase thereof, until authorized by the Committee.*

Certifications of transfer and registry must be dated and signed by an authorized officer of the transfer agent and registrar, respectively.

A change in the form of a security of a transfer agency, or of a registrar, shall not be made without the approval of the Committee.

## FORMS OF CERTIFICATES, ENGRAVING, ETC.

### General Requirements

(See Specific Requirements below.)

All securities for which listing upon the Exchange is requested, except as otherwise herein stated must be engraved and printed in a manner satisfactory to the Committee from at least two steel plates by an engraving company whose work the Committee is authorized by the Governing Committee to pass upon; the name of the engraving company must appear upon the face of all securities and also upon the face of coupons and the title panel of each bond. Securities must bear a vignette upon their face.

Said plates shall be: (1) *A border and tint plate* from which should be made a printing in color underlying important portions of the face printing; (2) *A face plate* containing the vignettes and descriptive or promissory portion of the document, which should be printed in black or in black mixed with a color. The combined effect of the impression from these plates must be as effectual security as possible against counterfeiting.

The printing of securities must be in distinctive colors, to make classes and denominations readily distinguishable.

All certificates, except as otherwise stated herein, must provide for transfer and for registration with dates. When a corporation makes transfers of its shares in other cities, certificates shall be identical in color and form, except as to names of transfer agent and registrar; certificates interchangeably transferable must bear a legend reciting the right of transfer in New York and other cities.

*The Committee recommends that the text of securities shall provide for transfer in person or by duly authorized attorney upon surrender of the security properly endorsed.*

A change in the form of a security, transfer agency, registrar, or trustee of bonds, shall not be made without the approval of the Committee.

*The Committee will object to any security upon which an impress is made by a hand stamp, except for a date or power of substitution.*

### Bonds

(In addition to the General Requirements above outlined, the following apply specifically to bonds.)

All bonds must be fully engraved and printed in a manner satisfactory to the Committee; face of bonds and coupons must bear a vignette.

The text of bonds should recite conditions of issuance, tax exemption,

terms of redemption (by sinking fund or otherwise), convertibility, default, interchangeability or exchangeability of coupon and registered bonds, and conversion into other securities.

Bonds, in the text and on the reverse, must recite payment of principal and interest in the Borough of Manhattan, City of New York, and provide for transfer and registration. Coupons must recite payment of interest in the Borough of Manhattan, City of New York and tax exemption.

Registered bonds must carry a power of assignment in such form as the Committee may approve.

*The Committee recommends that registered bonds be made interchangeable with coupon bonds.*

Registered bonds interchangeable with coupon bonds shall bear a legend reciting numbers and denominations of coupon bonds, against which they are issued.

If coupon bonds of any denomination are interchangeable with coupon bonds of other denominations they shall contain such recital in the text and bear an appropriate legend on the reverse.

*Registered bonds made such by detaching coupon sheets are not eligible for listing.*

### Forms of Legends for Bonds

For coupon bonds of one denomination interchangeable with coupon bonds of other denominations:

"As provided in the Indenture, coupon bonds of the denominations of \$1,000, \$500 or \$100, at any time outstanding, when surrendered with all unmatured coupons attached and upon the payment of charges, may be exchanged for an equal aggregate principal amount of coupon bonds of any other denomination of the same issue, of numbers not contemporaneously outstanding, with all unmatured coupons attached."

For a coupon bond of a thousand dollars exchangeable for coupon bonds of smaller denominations:

"The holder of this bond may, at his option, on surrender and cancellation and on payment of charges, as provided in the indenture, receive in exchange coupon bonds of this issue for an amount aggregating \$1,000 in denominations of \$.....of numbers not contemporaneously outstanding."

For coupon bonds of smaller denominations exchangeable for a \$500 or a \$1,000 coupon bond:

"The holder of this bond may, at his option, on surrender and cancellation of this bond and others of the same issue aggregating \$500 or \$1,000 and on payment of charges as provided in the indenture, receive in exchange a coupon bond of this issue of a number not contemporaneously outstanding, for the amount aggregated."

For registered bond(s) issued for coupon bond(s) of denomination(s) of less than \$1,000:

"This bond is issued in exchange for coupon bond(s) of this issue numbered.....in denominations of \$.....not contemporaneously outstanding, aggregating the face value hereof and coupon bond(s) of this issue bearing the said number(s)

and of the same denomination(s) will be issued in exchange for this bond upon surrender, cancellation and payment of charges provided in the indenture."

For registered bond(s) issued for \$1,000 coupon bond(s) :

"This bond is issued in exchange for coupon bond(s) of this issue numbered.....for \$1,000 (each), not contemporaneously outstanding, and coupon bond(s) of this issue bearing the said number(s) will be issued in exchange for this bond upon surrender, cancellation and payment of charges provided in the indenture."

### Stock

(In addition to the above General Requirements, the following apply specifically to stock certificates.)

The border and tint plate for one-hundred share certificates of stock shall have *said denomination engraved thereon in words and figures; the plates for smaller amounts shall bear some engraved device whereby the exact denomination of the certificate may be distinctly designated by perforation*; also conspicuously upon the face "*Certificate for less than one hundred shares.*"

Certificates of every class of stock shall recite the preference of all classes, if required by the laws of the state of incorporation. If not so required, certificates must contain at least a complete statement of the preference of the class of stock represented thereby, and also a statement that other classes of stock are authorized and that a printed copy of the preference of all classes of stock will be furnished to stockholders on request.

Certificates of stock shall recite (1) ownership; (2) par value; (3) whether shares are *full* paid and (4) non-assessable; (5) preference as to dividends; (6) distribution of assets upon dissolution or merger; (7) terms of redemption; (8) convertibility; (9) voting power, or (10) other privilege; and (11) must bear the following legend:

*This certificate is not valid until countersigned by the transfer agent, and registered by the registrar.*

The following form is required upon the reverse of a certificate of stock :

For value received.....hereby sell, assign and transfer unto.....  
 .....shares  
 of the \*capital stock represented by the within certificate and do hereby irrevocably constitute and appoint  
 .....attorney  
 to transfer the said stock on the books of the within named company with full power of substitution in the premises.

Dated.....19.....

In presence of  
 .....

Notice: The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular without alteration or enlargement, or any change whatever.

\*On certificates without nominal or par value the word "capital" may be omitted.

### Certificates of Deposit, Voting Trust Certificates, etc.

In addition to the General Requirements above outlined, certificates of deposit and voting trust certificates must conform in every particular to the Specific Requirements as to stock certificates, except that the descriptive



portion of a certificate of deposit may be typed satisfactorily to the Committee.

### Temporary Certificates or Receipts

Temporary certificates or receipts must conform to the General Requirements above outlined and to the Specific Requirements as to stock certificates, except that the text may be typed satisfactorily to the Committee, and need not bear a vignette.

### REMOVALS OR SUSPENSIONS IN DEALINGS OF LISTED SECURITIES

Whenever it shall appear that the outstanding amount of any security listed upon the Stock Exchange has become so reduced as to make inadvisable further dealings therein, the Committee may direct that such security be removed from the list and further dealings therein prohibited.

"The Governing Committee may suspend dealings in the securities of any corporation previously admitted to quotation upon the Exchange, or it may summarily remove any securities from the list."

### Special Requirements for Listing Foreign Shares

Subject to its right to waive or amend these requirements, the Committee on Stock List has adopted the following requirements for listing foreign shares:

1. To be available for listing, foreign shares must be in the form of certificates issued by an approved American institution or by the American branch of an approved foreign institution based upon the deposit with a foreign correspondent of the original foreign shares.

2. Applications must be signed by the company and endorsed by Bankers to the Issue satisfactory to the Committee on Stock List or must be made on behalf of and signed by Bankers to the Issue satisfactory to the Committee on Stock List.

3. Conditions of issuance of Certificates of Deposit must be such that shares deposited abroad may be released upon cable advice upon the cancellation of such Certificates of Deposit and that additional Certificates of Deposit may be issued in New York upon cable advice from the foreign depository of the deposit of additional shares. The Committee may approve restrictions upon such interchangeability for a reasonable period.

4. Until further action Certificates of Deposit should be in registered form only. The precise form will be considered at the time of application without, until further notice, prescribed rules in relation thereto, excepting that such certificates should comply with requirements of New York State law as to negotiability. The agreement covering such Certificates of Deposit must provide that no original foreign shares against which there are any outstanding "oppositions" shall be accepted for deposit and must also provide for the publication to American certificate holders of a summary, in the English language, of the current annual reports of the company.

5. Application should name the Exchanges upon which the security is listed and whether it is dealt in for the term settlement or for the cash settlement only.

6. The application must state affirmatively that there are no governmental restrictions against the payment of interest or dividends to American



holders or against the payment of the proceeds of sale to an American holder who sells in the market of origin.

7. In determining availability for listing, the Committee will give consideration to all matters affecting marketability, including the total number of shares issued, the initial number upon the American market, and the facility with which domestic and international transactions may be effected. The application should give all facts necessary for the determination of these questions.

8. No foreign share securities will be listed unless the company or its predecessor or constituent companies has been in operation for at least two (2) full years. The application should include the last two (2) annual balance sheets and income statements for at least two (2) full years.

9. The share securities of small companies will not be listed. In considering size available for listing, the nominal capitalization, the market price of securities to be listed, and the amount of the earnings will be accorded due weight.

10. No securities will be listed of any foreign company which is in default in any of its obligations, other than default occasioned by currency depreciation beyond control of the company. A statement in regard to this should appear in the application.

11. Until further action by the Committee, it will not recommend for listing corporate securities the nominal value of which is expressed in terms of, or the income from which is payable to security holders in, a currency which is not upon a gold basis.

12. Applications should state specifically that provision has been made for maintenance of a Fiscal Agent in New York City where all dividends on outstanding American certificates will be payable at current rates of exchange. Such dividends should be remitted promptly and paid to certificate holders by check without deduction except for reasonable charges and necessary expenses. Where desired the Fiscal Agent can be the same institution which issues the American certificates. Such Fiscal Agent or the institution issuing the American certificates must agree to mail to registered holders thereof, at their last known address, copies of all notices received affecting the interests of such holders in the deposited securities.

13. Each application should state clearly all taxes which, under existing law, may be imposed upon the holder of American certificates, directly or indirectly.

14. Accounting statements appearing in the application must be in form satisfactory to the Committee and, as far as possible, should disclose the same amount of information in regard to the affairs of the foreign company as are normally disclosed by the application of an American company.

15. The application should contain a summary of all important provisions of the actions under the authority of which the securities to be listed are issued and should be accompanied by an English translation of all papers and documents required for domestic listings.

16. The nature of the disposition of the proceeds of a corporate issue will be a factor affecting its availability for listing.

17. The application should include a detailed statement of any fees, other than those ordinarily applying in the case of domestic securities, which may be charged to any one holding or dealing in the securities and should state to whom such fees are payable.

### Special Requirements for Listing Foreign Government Bonds

Data required in addition to Regular Requirements in connection with proposed Listings.

1. (a) Statement of debt, internal and external, and currency in which it is to be paid; statement of external debt to be computed in dollars.  
(b) Contingent and actual liabilities, and priority.  
(c) Revenue or assets pledged, if any, under present and other loans, and nature of administration.  
(d) Summary of such revenue receipts and income from such assets for preceding five years, stated in dollars, if available.  
(e) Status of the law under which said revenue or assets are pledged.
2. Past debt record with respect to:  
(a) Defaults;  
(b) Scaling down interest payments;  
(c) Suspending sinking fund payments.
3. Where listed.
4. Currency in which interest and principal are to be paid.
5. Tax liability and exemption.
6. Statement of governmental income and expenditure for whatever account in the preceding five years.
7. Statement of the sums required, in dollars, to meet foreign interest charges in each of the five preceding years.
8. Statement in terms of weight and dollars (converted) of merchandise imports and exports in each of the preceding five years.
9. Statement of covenants, if any, with respect to payment of principal and interest of bonds dependent upon state of Peace or War and nationality of holder.

### Tentative Special Requirements for Listing Investment Trust Securities

The Committee on Stock List is prepared to receive applications to list the securities of certain types of companies commonly designated as Investment Trusts and to consider each application on its merits.

The Committee regards as falling within this designation such companies as are engaged primarily in the business of investing and reinvesting in the securities of other corporations for the purpose of revenue and for profit, and not in general for the purpose of exercising control.

As companies of this nature represent a relatively recent development in American finance, the Committee designs, in promulgating these requirements, merely to give to prospective applicants information as to the policies which will guide it in the light of its present knowledge. As experience with conditions gained through actual applications progresses, the right is reserved to alter or amend these requirements, in the discretion of the Committee, without notice.

For the present, applications for listing securities of Investment Trusts will be considered only when such trusts are of the general or management type.

In order that securities falling within this category may be eligible for listing, an application must be filed with the Secretary of the Exchange in

the manner prescribed in a circular of the Committee dated July 1, 1925 (or any future amendments thereof) and contain the information and be accompanied by the required documents, in so far as the provisions of that circular are applicable.

#### NON-PUBLICATION OF APPLICATIONS

Until further notice the names of investment trusts which apply for listing of their securities shall not be published, inasmuch as refusals may be frequent until satisfactory final requirements for listing shall have been developed through experience. At a later date the usual publicity may be given to the names of applicants.

#### MANAGEMENT

Each application for listing a security of an investment trust, as defined above, must state whether such trust is to be managed independently by its own officers and directors or whether it is to be managed directly or indirectly by other individuals, firms or corporations. The names of all individuals, firms or corporations which are directly or indirectly responsible for the management must be set forth, and there must be included in the body of the application a summary of all significant provisions contained in the Charter, Articles of Incorporation and By-laws of the Company, and all significant provisions contained in any existing agreements or contracts which define the powers and privileges of the management and the restraints thereon.

Copies of all of these documents must be submitted with the application.

These requirements apply likewise to any subsidiaries existing at the time of the application.

If the investment trust is managed exclusively and independently by its own officers and directors, the affiliations of such officers and directors with other firms or corporations must be stated.

If the investment trust is managed directly or indirectly by another individual, firm or corporation, a copy of each contract with such individual, firm or corporation must be included in the body of the application.

Each application must present full details regarding the basis on which compensation for management is computed, including direct payments, options, warrants and any other form of direct or indirect compensation either present or future.

Applicant companies must agree promptly to advise the Exchange, on behalf of themselves and of any subsidiaries which have been or may be formed, of any change in the terms or conditions of any management contracts existing at the time of listing and of the terms and conditions of contracts subsequently concluded. In like manner applicant companies and subsidiaries must agree to inform the Exchange of all changes in terms and conditions of option warrants.

#### OPERATING EXPERIENCE

No fixed period of actual existence as an operating investment trust is now stipulated before the applicant is eligible for listing, but such reasonable period will be required as in the judgment of the Committee has demonstrated that the applicant is a successful operating organization. The required period may be made to depend upon the organization's size and the purpose of the trust.

## SIZE

In order to be eligible for listing the aggregate value of the capital, surplus and funded debt of an investment trust, whether managed independently and directly by its own officers and directors or managed directly or indirectly by other individuals, firms or corporations, should be of such minimum size as will, in the opinion of the Committee, permit successful operation as an investment trust. Such required aggregate of capital, surplus and funded indebtedness will depend upon the organization and purposes of the trust and other general considerations.

## ORGANIZATION EXPENSES

Each application must show in detail all costs of organization and all expenses of selling each class of securities of such trust which may have been issued, together with a precise statement of the net proceeds to the company of each issue of its securities. Excessive costs of organization and of selling the several classes of securities of an investment trust may be considered as a bar to listing, unless such excessive costs have been absorbed prior to the date of the application.

## LOANS

If the application indicates that the company has an excessive amount of unfunded debt or if subsequent reports indicate that such unfunded debt exceeds or tends to exceed prudent limits, the application may be rejected or the securities of the investment trust in question may be stricken from the list, as the case may be.

## COMMISSIONS

As a prerequisite for listing, each individual, firm or corporation which is directly or indirectly concerned with the management of an investment trust and collectively constituting the managers of the trust must agree either with the New York Stock Exchange or in the management contracts with the investment trust that on any securities listed on any recognized stock exchange only the commissions authorized by such exchange shall be charged by such managers on securities bought or sold by such managers for the account of the investment trust and that only customary and reasonable commissions shall be charged by them on unlisted securities which shall be purchased or sold.

## NON-VOTING STOCK

In case an investment trust has issued one or more classes of stock which are entitled to preferential dividends but which do not carry the right to vote, such stock shall be accorded the *right to vote* at all times that as much as one year's preferential dividends are in arrears, and the right to vote shall continue until arrears have been liquidated. No Non-Voting stocks will be listed unless substantially preferred as to both dividends and assets.

## STATEMENT OF EARNINGS AND SURPLUS

A comprehensive and detailed statement of earnings and surplus shall be prepared and published within thirty days after the close of at least each annual fiscal period. Such statement shall also be submitted to stock-



holders at least fifteen days in advance of the annual meeting of the investment trust. The statement shall show separately gross earnings, if any, under at least the following classifications:

- Interest
- Dividends
- Profit on sale of securities
- Profit in syndicate participations
- Transfers from reserves previously created, if any
- Miscellaneous.

Only actual realized earnings shall be shown in the income account or shall be reflected in the balance sheet figures.

In case the item "Miscellaneous Earnings" appears to the Committee to require explanation, such item must be further classified as to origin.

The Income Account shall include all revenue, as well as all losses, from whatever source derived. It shall reflect in the aggregate a profit or loss upon each and every completed transaction consummated by a purchase and sale of securities. A technical short sale against a long position must not be used for the purpose of considering any transaction as incomplete.

Stock dividends must not be considered as income.

The Income Account shall include no profits resulting from participation in a syndicate, offering securities to the public, until such syndicate is closed. If the applicant enters into any other operations in account with others, the profit or loss at the date of each published financial statement must be reflected therein.

As a footnote to the Income Account there shall be a clear statement of the increase or decrease during the current year of the amount by which the market value of the securities held exceeds or is less than their book value.

If reserves against possible losses are set aside out of profits, the Income Account must show the amount so appropriated during the current accounting period, and the accrued reserves to date against losses shall also be shown in the balance sheet.

Expenses and deductions must be reported in such reasonable detail as the Committee may determine, including showing separately, at least:

- Interest paid and accrued
- Taxes paid and accrued
- Transfers to reserves, if any.

The statement of surplus shall show the amount carried forward as surplus from the immediately preceding period and indicate in detail all additions thereto and deductions therefrom.

### BALANCE SHEET

A comprehensive and detailed balance sheet shall be prepared and published within thirty days after the close of each year. Such balance sheet shall also be submitted to stockholders at least fifteen days in advance of the annual meeting of the investment trust.

The valuation of securities held must be shown upon the balance sheet at cost, summarized in reasonable detail. There must be appended to each balance sheet a footnote showing the aggregate cost of all securities owned, their aggregate current value, and the difference.



## INVESTMENTS

The applicant shall publish with the annual report a statement showing the value of securities held either directly or indirectly at the close of each period covered by the report. Valuation of securities for this statement shall be based upon market price of all securities listed on recognized stock exchanges and upon fair appraisal of other securities. There must be contained in the report a complete list of all of the holdings of the company showing names and quantities with the proviso that no more than an amount of ten (10%) per cent of the company's aggregate capital and surplus or ten (10%) per cent of the cost of securities held, whichever may be less, may be covered under a heading "Miscellaneous Securities," provided that such securities have not been held for more than one year. This list should disclose the aggregate cost of the securities and their aggregate market value, and in the case of holdings not listed on the New York Stock Exchange or the New York Curb Market, the price at which each such holding has been inventoried for the purpose of determining aggregate market value must be clearly set forth with such supporting information as may seem desirable.

## AUDITORS' CERTIFICATE

There must be appended to all financial statements and inventories required by the Committee, the certificate of a public accountant, qualified under the laws of some state or country, which certificate shall contain a statement that no one of the items carried under the term "Miscellaneous" in the list of Investments has been held for more than one year.

## SUBSIDIARIES

In case the investment trust holds, either directly or indirectly, a majority interest in the voting stock of another company at the time of any earnings report, such other company shall be considered as a subsidiary. Each balance sheet and earnings statement shall be presented in one of the following forms:

1. A fully consolidated balance sheet and earnings statement, prepared in such manner as to include each subsidiary, as defined above, and also to show any minority equities in both earnings and assets. Securities owned by each subsidiary shall be presented separately, as indicated under the requirement entitled "Investments."

2. Separate earnings statements and balance sheets for each subsidiary, together with a separate tabulation of the securities of such subsidiary, in accordance with the requirements entitled "Balance Sheet" and "Investments." In case this alternative is adopted the valuation assigned upon applicant's Balance Sheet to its equity in such subsidiary or subsidiaries should be shown separately and should not be greater than the cost thereof.

In any statement as to the market or appraised value of such subsidiary company securities, as carried upon the parent company's books, the appraised value should not be greater than the book value of such equity as determined from the books of such subsidiary, valuing the securities held by the latter at not more than cost for this purpose.

### Agreements for Investment Trusts

The....., in consideration of the listing of the securities covered by this application, agrees with the New York Stock Exchange as follows:

1. To notify the New York Stock Exchange promptly of any change in the general character or nature of its business.

2. To notify the Stock Exchange promptly in the event of any substantial change in the management or affiliations of the Corporation.

3. To publish within thirty days after the close of each fiscal year, and submit to stockholders at least fifteen days in advance of the annual meeting of the corporation, a Balance Sheet, an Income Statement for the last fiscal year and a Surplus statement of the applicant company as a separate corporate entity and of each corporation in which it holds directly or indirectly a majority of the voting stock; or, in lieu thereof, eliminating all intercompany transactions:

(a) a similar set of financial statements fully consolidated as to the applicant company and all corporations in which it owns directly or indirectly a majority of the voting stock, or

(b) a similar set of financial statements consolidated as to the applicant company and specifically named or described subsidiaries, with separate similar financial statements for each unconsolidated corporation in which the applicant company holds directly or indirectly a majority of the voting stock.

Such statements shall disclose fully the nature and extent of the interest of the applicant company in the corporations whose unconsolidated financial statements are furnished, and also the existence of any default in interest, cumulative dividend requirements or sinking fund or redemption fund requirements of any of the corporations whose accounts are thus consolidated or separately shown.

4. To publish in each annual report, as a footnote to the balance sheet, a statement showing the aggregate value of securities held directly, or indirectly, at the close of the period, based upon market value for all securities listed on recognized stock exchanges and upon fair appraisal of other securities, compared with the aggregate cost of such securities.

5. To publish in each annual report a footnote to the Income Account showing the increase or decrease during the current year of the amount by which the market value of securities held exceeds or is less than their book value.

6. To publish in each annual report a list of securities held showing names and quantities, provided, however, that an amount equal to ten (10%) per cent. of either the combined capital and surplus of the Corporation or of the cost of the securities, whichever is lower, may be combined under the heading "Miscellaneous." This list shall disclose the aggregate cost of the securities and their aggregate market value, and in the case of securities not listed on either the New York Stock Exchange or the New York Curb Market, the price at which each such holding is inventoried for the purpose of determining aggregate market value will be clearly set forth with such information as may be required to support such valuation.

7. To append to all annual financial statements and inventories required by the Committee the certificate of a public accountant qualified under the laws of some State or Country, which certificate shall include a statement

that no one of the items carried under the term "Miscellaneous" in the list of Investments has been held for more than one year.

8. To publish all future annual financial statements of any character, in the form contained in the listing application and, in the publication of reports of earnings for any period of less than a fiscal year, to show net profits in the aggregate and per share after Depreciation, Depletion, Income Taxes and Interest, estimating the proportionate amount of these items as accurately as may be if not finally determined at date of publication.

9. Not itself, and not to permit any subsidiary, directly or indirectly controlled, to take up as Income stock dividends received at an amount greater than that charged against Earnings, Earned Surplus or both of them by the issuing Company in relation thereto.

10. Not to pay any cash or stock dividends on Common Stock when such dividends, plus the amount by which the current value of securities held shall be less than their cost, exceed the earned surplus and undivided profits, without at the time of the payment of such dividends sending to stockholders a statement, in a form which has been approved by the Committee on Stock List, setting forth clearly the net impairment which will exist after the payment of such dividends stated both in aggregate dollars and dollars per share of Common Stock. If at the time of the payment of any such dividends the corporation has senior securities outstanding such statement shall, in addition, state in terms of percentage the ratio of the Common Stock equity, remaining after the declaration of such dividends, to such senior securities, taken at par value or the sum to which they would be entitled upon involuntary liquidation, whichever is the greater. For the purpose of this agreement, stock dividends shall be charged against earnings on a basis approved by the Committee on Stock List.

11. To notify the Stock Exchange, on behalf of itself or any subsidiaries which have been, or may be formed, of any change in the terms of any management contract existing at the time of listing and of the terms and conditions of contracts subsequently consummated.

12. To maintain, in accordance with the rules of the Stock Exchange, a transfer office or agency in the Borough of Manhattan, City of New York, where all listed securities shall be directly transferable, and the principal of all listed securities with interest or dividends thereon shall be payable; also a registry office in the Borough of Manhattan, City of New York, south of Chambers Street, other than its transfer office or agency in said city, where all listed securities shall be registered. If its transfer books should be permanently closed, to continue to split up certificates of listed stock into smaller denominations in the same name so long as such stock shall be retained upon its list by the New York Stock Exchange. If its transfer office or agency should be or should become located north of Chambers street, to arrange, at its own cost and expense that its registry office will receive and re-deliver all securities deposited at such registry office for the purpose of transfer.

13. To notify the Stock Exchange thirty days in advance of the effective date of any change in the authorized amounts of listed securities.

14. Not to add to the number of its transfer agencies, nor to make any change of a transfer agency or of a trustee of its bonds or other securities without prior notice to the Committee on Stock List, and not to make any change in its listed securities, nor to add to the number of the registrars of its stock, nor to change a registrar of its stock, without the prior approval

of the Committee on Stock List; nor to select an officer or director of the company as a trustee of its mortgages or other listed securities, unless such officer or director be a co-trustee for an issue having a corporate trustee.

15. To notify the Stock Exchange in the event of the issuance or creation in any form or manner of any rights to subscribe to, or to be allotted, its securities, or of any other rights or benefits pertaining to ownership in its securities, and to afford the holders of its listed securities a proper period within which to record their interests and to exercise their rights, and to issue all such rights in form approved by the Stock Exchange and to make the same transferable, payable and deliverable in the Borough of Manhattan, City of New York.

16. To notify the Stock Exchange promptly in the event of issuance of Options or Warrants to purchase stock, otherwise than pro rata to stockholders, of the number of shares covered by such Options, of their terms and of the time within which they may be exercised and of any subsequent changes therein and thereafter to include this information together with like information as to any Options in existence at the time of approval of this application so long as said Options are outstanding, in all annual financial reports furnished to stockholders and in all formal published reports.

17. Not to purchase or otherwise acquire for its own account, or indirectly through a subsidiary, shares of its common stock, however designated, otherwise than under exceptional and special circumstances. In case any such purchase is made, to submit promptly to the Committee on Stock List all relevant facts in connection therewith, and upon request of the Committee to take such steps as the Committee deems necessary to make such re-acquired shares unavailable for trading without further application.

18. To make application to the Stock Exchange for the listing of additional amounts of listed securities sufficiently prior to the issuance thereof to permit action in due course upon such application.

19. To publish promptly to holders of stock any action in respect to dividend on shares, or allotments of rights for subscription to securities, notices thereof to be sent to the Stock Exchange, and to give to the Stock Exchange at least ten days' notice in advance of the closing of the transfer books, or extensions, or of the taking of a record of holders for any purpose.

20. To forward to the Stock Exchange copies of all notices mailed to stockholders looking toward charter amendments, and to file with the Stock Exchange a certified copy of amended charter, or Resolutions of Directors in the nature of amendments, as soon as such amendments or resolutions have become effective.

21. Not to purchase preferred stock for redemption except in the open market and not to select preferred stock for redemption otherwise than pro rata or by lot; to notify the Stock Exchange immediately and at least fifteen (15) days in advance of any such redemption, and to furnish to the Stock Exchange any information requested in reference to such redemption.

22. To notify the Stock Exchange of the change or removal, to a substantial extent, of collateral deposited under any of its mortgage or trust indentures under which listed securities are outstanding.

23. To have on hand at all times a sufficient supply of certificates to meet the demands for transfer.

24. If at any time the stock certificates of the company do not recite the preference of all classes of stock the company agrees with the Exchange



that it will furnish stockholders, upon request and without charge, with a printed copy of the preferences of all classes of stock.

25. To furnish the New York Stock Exchange, on demand, such reasonable information concerning the company as may be required.

.....  
By .....

## Report of the Special Committee on Stock Dividends New York Stock Exchange

In the requirements for the listing of investment trusts recently promulgated by the Stock Exchange, a provision was incorporated to the effect that investment trusts should not include stock dividends in their income accounts. In recent weeks, the wisdom of this ruling has been the subject of discussion between the Stock Exchange and representatives of many companies affected by its operation, and a special committee has been looking into the question of stock dividends from the point of view of the Exchange with a view to clarifying the issues involved.

Based on the report of this committee to the Governing Committee, the following statement of position is made: The interest of the Stock Exchange in the method by which companies account for stock dividends arises out of its consistent policy of attempting to obtain, in connection with corporate returns, such a clear disclosure of the relevant facts as will enable the investor to properly appraise the listed securities in which he is interested.

The stock dividend has, in late years, become an important instrument in the financial policy of American corporations, and there can be little doubt that its use is still in the early stages of development. In particular is it of value to corporations in growing industries requiring the use of large additional amounts of capital, as it permits them in some measure to obtain this capital in the simplest manner from their own stockholders, and, at the same time, permits these stockholders, if they are so inclined, to realize upon their share of current or past earnings so capitalized.

Coincident with the development of the stock dividend, there has taken place the development of the less than \$100 par and of the no par value stock, together with the practice of having large capital or paid in surpluses; and these relatively new conceptions have led with increasing frequency to the corporate practice of partial or complete recapitalization through the form of so-called "split-ups."

As a matter of definition from the point of view of the Exchange, a true stock dividend represents the capitalization, in whole or in part, of past or current earnings; while a split-up has not of necessity any relation to earnings and may mean nothing more than a change in the form in which ownership in an existing situation is expressed.

Accounting practice, in striving to adapt itself soundly to these important developments in corporate procedure, has not yet reached the point where a mere perusal of the year's accounts will suffice to reveal to the average investor in what manner he has been affected by action taken during the year in the matter of stock dividends. On this account, it is felt that the Exchange is justified in seeking to obtain wherever possible for the benefit of the investor such supplementary information as may assist him to a correct understanding of the accounts themselves.



Applications for listing which involve questions relating to stock dividends will be considered in the light of the foregoing. In view of the large and constantly increasing number of listings on the Exchange, either originating in stock dividends or involving questions that have to do with stock dividends, an effort will be made to obtain for the investor such information as may place him in the position to determine in connection with stock dividends received by him, to what extent they constitute true stock dividends representing the capitalization of current or past earnings, and to what extent, if at all, they represent merely split-ups involving an expression in a new form of what was already his. In any event, it is felt that the individual investor should make such independent investigations as seem desirable in order to be quite sure that he understands in each instance how he has been affected by the declaration of a stock dividend.

When stock dividends are received by investment trusts, holding companies or other corporations, the manner in which these dividends are accounted for by the receiving company presents a problem somewhat different from that attending the accounting for the payment of stock dividends by the declaring company. Current practice varies all the way from the policy of ignoring stock dividends in their entirety in the income account of receiving companies, to the policy of taking them into the income account whether they have been realized upon or not at the full market value on the date received.

Uniform accounting practice today seems to favor as sound procedure the ignoring of stock dividends in the income account of receiving companies. However, it has been urged on behalf of investment trusts, holding companies and others, with what seems to us to be some measure of justification, that a technical interpretation of the nature of stock dividends may operate to hamper management in the adopting of perfectly reasonable and proper dividend programs of their own, whether in cash or in stock, and may even under certain circumstances force them as recipients, for technical reasons, to realize upon stock dividends which for business reasons they would have preferred to hold.

It may be that accounting practice will undergo certain modifications in the light of these new tendencies, but it is too early to form an opinion as to the direction that this modification is apt to take. It is possible that a schedule of all stock dividends received will suggest itself as a desirable addition to the annual report of investment trusts, holding companies and others; or, conceivably, a new departure in accounting theory may permit the inclusion of stock dividends in some form or other in the income accounts of receiving companies.

At the present time, it appears as if the Exchange could go no further than to take the position that it will raise no objection to the method by which investment trusts, holding companies and others account for stock dividends received by them and not realized upon, provided there is the fullest disclosure of the procedure adopted, and provided that these are not included in the income accounts of the receiving companies at a greater dollar value per share than that at which they have been charged to income account or earned surplus account by the paying companies. The manner in which receiving companies account for stock dividends received by them and realized upon during the period under review is a matter which the committee will pass on in connection with each specific instance.

## New York Stock Exchange Further Announcement on Stock Dividends

The following statement supplements and extends but does not alter the Report of the Special Committee on Stock Dividends adopted by the Governing Committee on September 11, 1929.

In the study of the questions leading up to that report and in considering the problems arising out of giving effect to it, the Committee on Stock List has reached the following definite conclusions, which it seems well to make public for the information of corporations desiring listing:

As recognition of the importance of earnings in the evaluation of securities tends to be emphasized, the importance of an accurate segregated statement of Earned Surplus in the Balance Sheet does so likewise. Accounting should be adapted to the end that this account should show at any given time the exact amount of realized undistributed earnings, either from date of organization, or, in the event of recapitalization, from some fixed stated date. The fact that state laws may permit stock dividends to be paid without any charge against earnings or earned surplus or with only a nominal charge has no bearing upon the correct accounting procedure to be followed.

An occasional large split-up, made for convenience in the form of a stock dividend and capitalized at a nominal amount, whether charged against Earned Surplus or Capital Surplus is not objectionable, if accompanied by a statement that it is in effect a split-up.

The issuance of periodical Stock Dividends with either no charge or with an insufficient charge against Earnings or Earned Surplus, while not illegal under the laws of some States, is apt to mislead stockholders and is not regarded as good practice. If such dividends are declared they should be accompanied by a statement clearly indicating either that they are not true earned stock dividends, or, if actually earned but insufficiently charged against Earnings or Earned Surplus, that the method of accounting leaves in Earned Surplus an amount which may be again used for dividends without further earnings.

In the accounting for Stock Dividends upon the books of the issuing Company, whether for stock with par value or without par value, Capital and Capital Surplus should be regarded together as the consideration, other than earnings, represented by the stock. The sum per share of these two accounts is the minimum amount, per share to be issued as a Stock Dividend, which should be charged against Earnings or Earned Surplus in order that such dividend may be termed a true earned Stock Dividend properly accounted for and in order that Earned Surplus may not include a fictitious amount available for further dividends without further earnings.

In cases where there exist substantial uncanceled assets, tangible or intangible, the amount of the charge against Earnings or Earned Surplus should be larger than this minimum amount.

In cases where stock is issued either as interest upon funded debt or as a dividend upon stock of another class with a cash alternative, the amount of such cash alternative measures the minimum amount properly to be charged against Earnings or Earned Surplus. The effect of issuing stock as interest or dividends upon other securities should be merely to conserve cash and not to add to the apparent Earnings or

the apparent Earned Surplus, as contrasted with the effect of the cash alternative.

The Exchange will not decline to list, for the present at least, ordinary periodical Stock Dividends insufficiently charged against Earnings or Earned Surplus, providing proper disclosure is made of the nature of such dividends. Stock issued as interest or as dividends upon other securities with a cash alternative will not be regarded as available for listing if it is to be charged against Earnings or Earned Surplus at less than the amount of cash surrendered, excepting as to further issuance of stock under such conditions in cases where such application or applications for listing the senior securities bearing such alternative Stock Dividends, may have been approved before the objections to the practice were clearly apparent, or unless accounting procedure should develop in a direction which cannot now be foreseen, in such manner as to warrant considering full disclosure as adequate protection to security holders of all classes.

The Exchange will not knowingly list any of the securities of a corporation which takes up as income upon its books Stock Dividends received at a larger figure than the proportionate amount charged against Earnings or Earned Surplus by the issuing Company. Where the issuing company declines to give this information, objection will be made if the receiving company regards such stock dividends as income to any extent whatever.

Attention is called to the fact that in the rapidly changing conditions of modern business, the Exchange is frequently called upon to consider from a listing standpoint an accomplished fact in corporate finance, upon which immediate action is imperative, without adequate time for the consideration of the new problems involved. Such action will not be regarded as creating a precedent upon which reliance may be placed, if further consideration indicates that the action taken is not in the best interest of the public and of the Exchange.

(IVf) In London, Amsterdam, Vienna, Berlin, and most other leading financial centers, there is no preliminary or curb market exchange. The *Coulisse*, or Curb Market of Paris, has largely been created by the statutes and arrangements imposed by the French Government upon the official Paris Bourse stock market in return for granting it a legal monopoly in its business. The New York Stock Exchange is alone among the great securities markets of the world in having turned away sufficient business by reason of the strictness of its voluntarily formulated listing requirements, to have allowed the rise of a separate major stock exchange (the New York Curb Market) beside it. It were well for those who sometimes criticize the New York Stock Exchange and its member firms for selfishness of policy, to recall this unique instance of sacrificing member-earnings for the ideal of safeguarding the public in its security investments.

(IVg) The Stock Exchange tries whenever possible to obtain the consent of applicant corporations to publish their earnings on a quarterly basis, in order more frequently to give the public a notion of the proper current value of their securities. This is not, however, always possible. Some companies are engaged in lines of business which are seasonal, and which might normally show losses in certain quarters and huge offsetting profits in others; such concerns are apt to claim that quarterly earnings only mislead investors and lead to unnecessary speculation. Other companies declare that quarterly earnings can be too easily manipulated (as, for example, with "special bargain sales" by dry goods stores), and that also this full disclosure of information would place them at a disadvantage with competing non-listed concerns who issue infrequent earning statements, or none at all. Foreign companies sometimes are compelled by virtue of the foreign statutes under which they were incorporated, to issue earning statements not oftener than once each year. Finally, the insistence by the Exchange on quarterly earnings has been a gradual evolution, and many old companies listed their securities years ago when their agreements with the Exchange thereto called for only annual or semi-annual earning statements; in such cases, of course, the Exchange cannot attempt to repudiate such agreements and substitute for them others calling for quarterly earning statements. These may be, in particular cases, valid and genuine difficulties in the way of uniformity. Yet they have not discouraged the Exchange from requiring quarterly earning statements unless good reason can be shown by the applicant for leniency in his particular case. It is also gratifying to record the hearty cooperation which the Exchange has received, in its long-continued campaign for more extensive corporate publicity, from some enlightened and progressive American companies like the U. S. Steel Corporation, which has gone further in this regard than the standard listing requirements of the Exchange could do.

#### (IVh)

#### Resolution

RESOLVED that application to be made to the New York Stock Exchange for the listing of.....  
 of this corporation and that.....be designated by  
 the corporation to appear before the Committee on Stock List of said  
 Exchange, with authority to make such changes in said application, or in  
 any agreements relative thereto as may be necessary to conform with re-  
 quirements for listing.



## Questionnaire

(To be signed by an officer of the company)

- .....193....
- This questionnaire accompanies application of the.....  
 .....  
 for the listing of.....
- 1—Is the management control of the Company held by any other Company through either stock ownership, lease or contract?.....
  - 2—Are there within your knowledge any syndicate or concentrated holdings of this security?.....
  - 3—Is there any restraint on any portion of the security?.....
  - 4—What dividends (if any), are in arrears on the preferred stocks either of the Company or of any of its subsidiaries?.....
  - 5—What dividends (if any) have been declared (and not paid) since the date of this application?.....
  - 6—What rights (if any) to subscribe to any present securities or new securities remain unsettled as of the date of this application?.....
  - 7—Are the transfer books to be closed or a record of stockholders to be taken in the near future for any purpose?.....
  - 8—Has there been any change in your Charter or By-Laws since previous filing with the Committee?.....
  - 9—Will you agree to publish quarterly statements of earnings showing net after all charges and taxes, and forward two copies to this Committee with a statement as to the manner and date of publication?.....
  - 10—Will you agree that all annual financial statements of the Company published for the benefit of stockholders will be in substantially the same form as contained in the listing application and with no less detail? .....
  - 11—If it is legal under your Charter will you agree to take a record of stockholders for dividends and meetings instead of closing your books? .....
  - 12—To avoid the congestion caused by the fact that numerous corporations have adopted the same date of record of stockholders for payment of dividends, will you agree to make your record date of stockholders for such purpose some date other than the 15th of March, June, September and December? .....
  - 13—When and by whom was the last audit of your books prepared?.....
  - 14—Will you make copies of the audits of your books available to the Committee on request?.....
  - 15—Have any other reports of a financial, accounting or engineering nature been made either on your behalf or on behalf of any banker or underwriting or banking group within the past three years? If so, please indicate the character of these reports and state whether they will be made available for the inspection of this Committee upon request? .....
  - 16—Is there any litigation pending or threatened that would affect the Company's income from, title to, or possession of any of its property? .....
  - 17—Will you agree to maintain the office of your Transfer Agent and Registrar south of Chambers Street in order to facilitate business? .....



- 18—The Committee in order to facilitate the business of the Exchange, desires that the transfer agent of your Company be directed to sign the Stock Transfer Department receipts for all stock submitted by the Stock Clearing Corporation for transfer. Will you so agree?.....
- 19—Will you agree to issue new certificates replacing lost ones forthwith upon notification of loss and receipt of proper indemnity, making any changes which may be necessary in your Charter or By-Laws to permit this to be done?.....
- 20—Will you agree that all calls for redemption (Foreign Bonds) published abroad will be published on the same day or days in a newspaper of general circulation published in the Borough of Manhattan, City of New York?.....
- 21—If action on your application is favorable how many copies of the application do you require printed for you at your expense?.....
- 22—In the event any additional papers should be required for the Committee's files, will you agree to furnish same on request?.....
- By.....

(IVi) "When a new stock is put on the exchange, or any great exchange like the New York Stock Exchange, there is one thing that is very necessary, and that is that its price shall be steady. When you have no active market in a stock, when you are building up an active market in a new stock, the first thing a banking house does, what it wants to do, and what it must do, whether it makes a profit or loss out of it, is to steady the price of the stock. If people come in to buy 6,000 or 7,000 shares of stock, and there is not much around if they do not sell the stock it will be bid way up, and have a big advance. On the other hand, if somebody comes in to sell 6,000 or 7,000 shares, and there are no large buying orders in there, the price of the stock is going to be a great deal lower than it would be otherwise. If you put in buying orders on a scale down and selling orders on a scale up, the effect of that is to steady the price of the stock. Its fluctuation is not as violent or as wide as it would be otherwise." (Money Trust Investigation, pp. 1282-1283, testimony of Mr. Henry; quoted in Regulation of the Stock Exchange, p. 542.)

(IVj) "Stocks in a liquidating market pass from what are described as weak hands to strong hands; stocks pass from the hands of those who buy them and carry them with borrowed money to those who buy them and pay for them. . . . The best evidence, Congressmen, of such a movement, I believe, is found in the stock books of

corporations whose stocks are dealt in on the exchange, where, in a period of liquidation, what is known as the odd-lot buyer appears in the markets; then, with stock like that of the Steel Corporation and General Motors and others, you will find the number of stockholders increases tremendously in a declining market. Figures have recently been published in New York market reviews showing the changes in the number of stockholders in those two companies. And what happens is that the public, in a declining market, see that stocks are selling at a bargain and come in with the cash, buy the stock, and take it out of the stock loan account." (Statement and testimony of Governor Benjamin Strong of the New York Federal Reserve Bank before the Agricultural Inquiry Commission [Washington, August, 1921], p. 630.)

(IVk) The only current statistical indication as to the "technical condition" of the stock market floating supply as a whole consists in the ratio of Stock Exchange member borrowings on security collateral to the market value of all listed shares. The publication of the former was undertaken February 1, 1926. Statistics (also as of the opening of business on the first of each month) as to the market value of listed securities have regularly been compiled by the Statistical Department of the Stock Exchange since January 1, 1925. This ratio, although far from a scientific method of measurement, presumably does indicate the periods when the relative size of the floating supply has become unusually great or unusually small. Thus, empirically, it did indicate the dangerous current technical condition of the stock market by rising to 10.23% on March 1, 1926, and to 9.83% on October 1, 1929. But the ratio can of course be deflected by the unusual use of bonds or unlisted securities as collateral. Also when both loans and stock values advance equally, the ratio might not change very much even when a condition of unusual inflation in both items had arisen.

(IVI) DISTRIBUTION OF UNITED STATES STEEL COMMON AND  
PREFERRED STOCKS, 1910-1928

Showing drift of shares from speculators (brokers' names) to investors  
(individual names)

| Date of Quarterly<br>Statement | COMMON STOCK |             | PREFERRED STOCK |             |
|--------------------------------|--------------|-------------|-----------------|-------------|
|                                | Brokers      | Individuals | Brokers         | Individuals |
| December 31, 1909...           | 66.41%       | 33.59%      | 17.57%          | 82.43%      |
| March 31, 1910...              | 63.94        | 36.06       | 16.79           | 83.21       |
| June 30, 1910.....             | 61.54        | 38.46       | 15.62           | 84.38       |
| September 30, 1910...          | 57.86        | 42.14       | 14.98           | 85.02       |
| December 31, 1910...           | 58.32        | 41.68       | 14.59           | 85.41       |
| March 31, 1911.....            | 58.36        | 41.64       | 14.59           | 85.41       |
| June 30, 1911.....             | 58.29        | 41.71       | 14.39           | 85.61       |

| Date of Quarterly<br>Statement | COMMON STOCK |             | PREFERRED STOCK |             |
|--------------------------------|--------------|-------------|-----------------|-------------|
|                                | Brokers      | Individuals | Brokers         | Individuals |
| September 30, 1911...          | 55.41%       | 44.59%      | 14.13%          | 85.87%      |
| December 31, 1911...           | 55.26        | 44.74       | 14.67           | 85.33       |
| March 31, 1912.....            | 54.54        | 45.46       | 14.39           | 85.61       |
| June 30, 1912.....             | 56.27        | 43.73       | 13.90           | 86.10       |
| September 30, 1912...          | 57.58        | 42.42       | 13.67           | 86.33       |
| December 31, 1912...           | 57.36        | 42.64       | 13.49           | 86.51       |
| March 31, 1913.....            | 54.71        | 45.29       | 13.75           | 86.25       |
| June 30, 1913.....             | 51.07        | 48.93       | 12.71           | 87.29       |
| September 30, 1913...          | 50.80        | 49.20       | 12.41           | 87.59       |
| December 31, 1913...           | 49.34        | 50.66       | 12.39           | 87.61       |
| March 31, 1914.....            | 49.86        | 50.14       | 12.64           | 87.36       |
| June 30, 1914.....             | 48.90        | 51.10       | 12.49           | 87.51       |
| September 30, 1914...          | 45.01        | 54.99       | 11.90           | 88.10       |
| December 31, 1914...           | 43.15        | 56.85       | 11.82           | 88.18       |
| March 31, 1915.....            | 42.33        | 57.67       | 11.59           | 88.41       |
| June 30, 1915.....             | 44.42        | 55.58       | 11.70           | 88.30       |
| September 30, 1915...          | 46.94        | 53.06       | 11.69           | 88.31       |
| December 31, 1915...           | 49.80        | 50.20       | 11.15           | 88.85       |
| March 31, 1916.....            | 53.87        | 46.13       | 11.02           | 88.98       |
| June 30, 1916.....             | 52.75        | 47.25       | 10.73           | 89.27       |
| September 30, 1916...          | 55.67        | 44.33       | 12.13           | 87.87       |
| December 31, 1916...           | 58.04        | 41.96       | 12.74           | 87.26       |
| March 31, 1917.....            | 53.16        | 46.84       | 11.39           | 88.61       |
| June 30, 1917.....             | 55.15        | 44.85       | 10.94           | 89.06       |
| September 30, 1917...          | 52.66        | 47.34       | 10.16           | 89.84       |
| December 31, 1917...           | 46.53        | 53.47       | 9.61            | 90.39       |
| March 31, 1918.....            | 44.51        | 55.49       | 9.37            | 90.63       |
| June 30, 1918.....             | 43.78        | 56.22       | 9.17            | 90.83       |
| September 30, 1918...          | 43.88        | 56.12       | 9.18            | 90.82       |
| December 31, 1918...           | 40.71        | 58.29       | 9.11            | 90.89       |
| March 31, 1919.....            | 38.91        | 61.09       | 9.00            | 91.00       |
| June 30, 1919.....             | 42.53        | 57.47       | 9.03            | 90.97       |
| September 30, 1919...          | 41.52        | 58.48       | 8.78            | 91.22       |
| December 31, 1919...           | 39.65        | 60.35       | 8.29            | 91.71       |
| March 31, 1920.....            | 33.46        | 66.54       | 7.88            | 92.12       |
| June 30, 1920.....             | 32.09        | 67.91       | 7.68            | 92.32       |
| September 30, 1920...          | 30.69        | 69.31       | 7.42            | 92.58       |
| December 31, 1920...           | 25.17        | 74.83       | 7.53            | 92.47       |
| March 31, 1921.....            | 24.27        | 75.73       | 7.22            | 92.78       |
| June 30, 1921.....             | 22.61        | 77.39       | 7.21            | 92.79       |
| September 30, 1921...          | 21.49        | 78.51       | 7.22            | 92.78       |
| December 31, 1921...           | 21.44        | 78.56       | 6.52            | 93.48       |
| March 31, 1922.....            | 22.00        | 78.00       | 6.41            | 93.59       |
| June 30, 1922.....             | 24.09        | 75.91       | 6.18            | 93.82       |
| September 30, 1922...          | 25.05        | 74.95       | 6.23            | 93.77       |
| December 31, 1922...           | 26.28        | 73.72       | 6.19            | 93.81       |
| March 31, 1923.....            | 26.24        | 73.76       | 6.24            | 93.76       |
| June 30, 1923.....             | 23.34        | 76.66       | 5.42            | 94.58       |
| September 30, 1923...          | 20.83        | 79.17       | 5.09            | 94.91       |
| December 31, 1923...           | 20.62        | 79.38       | 5.37            | 94.63       |
| March 31, 1924.....            | 22.39        | 77.61       | 4.97            | 95.03       |
| June 30, 1924.....             | 20.45        | 79.55       | 4.88            | 95.12       |
| September 30, 1924...          | 22.82        | 77.18       | 4.74            | 95.26       |
| December 31, 1924...           | 26.21        | 73.79       | 4.79            | 95.21       |
| March 31, 1925.....            | 26.81        | 73.19       | 4.82            | 95.18       |
| June 30, 1925.....             | 25.45        | 74.55       | 4.75            | 95.25       |

| Date of Quarterly<br>Statement | COMMON STOCK |             | PREFERRED STOCK |             |
|--------------------------------|--------------|-------------|-----------------|-------------|
|                                | Brokers      | Individuals | Brokers         | Individuals |
| September 30, 1925...          | 25.39%       | 74.61%      | 4.60%           | 95.40%      |
| December 31, 1925...           | 27.60        | 72.40       | 4.65            | 95.35       |
| March 31, 1926.....            | 29.92        | 70.08       | 4.82            | 95.18       |
| June 30, 1926.....             | 24.10        | 75.90       | 4.77            | 95.23       |
| September 30, 1926...          | 29.01        | 70.99       | 4.91            | 95.09       |
| December 31, 1926...           | 28.99        | 71.01       | 5.20            | 94.80       |
| March 31, 1927.....            | 27.59        | 72.41       | 5.45            | 94.55       |
| June 30, 1927.....             | 26.53        | 73.47       | 5.43            | 94.57       |
| September 30, 1927...          | 25.69        | 74.31       | 5.49            | 94.51       |
| December 31, 1927...           | 25.11        | 74.89       | 5.69            | 94.31       |
| March 31, 1928.....            | 23.86        | 76.14       | 5.62            | 94.38       |
| June 30, 1928.....             | 22.79        | 77.21       | 5.91            | 94.09       |
| September 30, 1928...          | 23.95        | 76.05       | 6.04            | 93.96       |
| December 31, 1928...           | 24.15        | 75.85       | 6.15            | 93.85       |
| March 31, 1929.....            | 23.68        | 76.32       | 6.29            | 93.71       |
| June 30, 1929.....             | 25.27        | 74.73       | 6.26            | 93.74       |
| September 30, 1929...          | 25.25        | 74.75       | 6.48            | 93.52       |
| December 31, 1929...           | 21.21        | 78.79       | 7.01            | 92.99       |
| March 31, 1930.....            | 22.00        | 78.00       | 6.80            | 93.20       |

(IVm) As long as a customer holds registered securities on margin with his broker, it is customary for them to be kept in the name of the broker or some other broker. In this way, they are salable at once on the Exchange, and if the customer fails or refuses to maintain proper margin, the broker can thus sell them readily to protect himself from loss. Also, apart from margin considerations, the customer may have purchased the securities with the intention of selling them in a short space of time, and this can be done with a minimum of delay when they are registered in a broker's name. But when an investor has bought securities outright, he will usually wish them transferred into his own name, so that he can place the certificates in his own safe deposit box. Some investors, however, may prefer to keep securities which they own outright in a broker's name, in order that the broker may collect dividends for them and perform similar services. On the other hand, for various reasons, stock in an individual's name may really be speculative rather than investment stock. Yet as a generalization, it is fair to say that stock in brokers' names represents the undistributed speculatively held floating supply, while stock in the names of individuals represents distributed stock owned outright by investors.

(IVn) The following statistical tables show the constantly widening public distribution of the common stock of three large American corporations—a public utility, an industrial, and a railroad, as of the earliest period in the years indicated:

|           | AMERICAN<br>TELEPHONE AND TELEGRAPH<br>COMPANY |                                     | UNITED STATES STEEL            |                                     | PENNSYLVANIA RAILROAD          |                                     |
|-----------|------------------------------------------------|-------------------------------------|--------------------------------|-------------------------------------|--------------------------------|-------------------------------------|
|           | Number<br>of Share-<br>holders                 | Average<br>Number of<br>Shares Held | Number<br>of Share-<br>holders | Average<br>Number of<br>Shares Held | Number<br>of Share-<br>holders | Average<br>Number of<br>Shares Held |
| 1910..... | 35,823                                         | 72                                  | 22,033                         | 230.70                              | 65,283                         | 126.41                              |
| 1914..... | 55,983                                         | 62                                  | 47,221                         | 107.64                              | 91,571                         | 109.04                              |
| 1917..... | 70,555                                         | 56                                  | 42,564                         | 119.42                              | 100,138                        | 99.82                               |
| 1920..... | 120,460                                        | 37                                  | 104,376                        | 48.69                               | 133,068                        | 75.04                               |
| 1927..... | 399,121                                        | 26                                  | 86,034                         | 59.80                               | 141,202                        | 70.72                               |
| 1930..... | 469,801                                        | 28                                  | 167,951                        | 48.42                               | 196,119                        | 58.60                               |

(IVo) The term "bucketshop" (French, *maison de contre partie*) may best be defined as a pretended brokerage firm which makes it a practice to take a position in the market opposite to that taken by its customers. Originally, American bucketshops did this by not actually buying or selling for its customers at all, and depending upon their misjudging the market. Such firms were largely driven out of business by a law enacted in New York State in 1913 which gives the customer the right to obtain from his broker the name of the firm to whom his stock has been sold, or from whom it has been bought.

This, unfortunately, did not abolish bucketshops, but only changed their methods of operation. The modern bucketshop executes the customer's initial order quite legitimately and is thus in a position to give him a correct confirmation as required by law. But secretly, and usually at once, the bucketshop proceeds to sell out his customer's "long" stock. If the price of the stock declines, the bucketshop can then regretfully pretend to close out his customer by selling, and keep that portion of the customer's margin which would have been lost had this delayed and pretended sale been actual. If, however, the stock rises in price, ultimately the bucketshop will be unable to pay its customers' profits out of its own pocket; accordingly, the bucketshop will suddenly declare its disastrous bankruptcy.

Since most inexperienced brokerage customers are buyers and "bulls," it consequently follows that in general bucketshops will make money when prices decline, and lose it when they rise. The truth of this generalization was seen in 1920-22. During the long "bear" market from November, 1919, to August, 1921, bucketshops reaped a harvest and often grew to large size. But after the turn in prices after the latter date, they began to lose money and in the late fall of 1921 they commenced to fail. Bucketshop insolvencies lasted until well into 1922, and caused immense public losses.

The permanent results of this bucketshop debacle might be summed up as (1) the liquidation of the Consolidated Stock Exchange of New York; (2) the higher organization of the New York Curb Market



as an indoor securities exchange; and (3) the extension of the security business of legitimate brokerage firms, and especially of Stock Exchange firms.

## CHAPTER V

### Security Speculation—Its Benefits and Dangers

(Va) Professor H. C. Emery, of Yale, defined speculation in the following terms:

"In the first place, it is well to recognize what we mean by speculation. The simplest definition is that speculation consists in buying and selling commodities or securities with an idea of making profits out of fluctuating values. Why do such fluctuations occur? Simply because the conditions of supply and demand are always changing. It is the exception rather than the rule for any article of commerce or any piece of property to maintain a perfectly stable price. Since the demand of society is constantly changing, values must constantly fluctuate, and, as long as values fluctuate, speculation must take place. It is not conceivable that, in a system of buying and selling such as we have, values could go up and down without somebody being benefited or injured, or without men consciously attempting to secure the benefit or avoid the injury by their purchases and sales. Speculation has always existed wherever buying and selling has existed—ever since the days when Joseph cornered the grain supply of Egypt as reported in the book of Genesis. As long as private ownership of property is allowed and the value of property varies, speculation will continue. . . .

"Some people speak as if all dealing in securities should be of a pure investment nature. They fail to realize, however, that investments themselves become speculative in proportion as speculation pure and simple is abolished. Investment means primarily the purchase of income-yielding property in order to get an annual income, rather than to make profits from the fluctuations in capital value; but since capital value does fluctuate, investment involves the risk of loss, and . . . this risk of loss to the conservative investor is made very much less when he has an active speculative market for the disposal of his property.

"Still another distinction that must be made is that between speculation and gambling. In the broadest sense, of course, there is a gambling element, not only in all bets, but in all our activities. If gambling means simply the taking of unreasonable risks, almost every act of our lives might be accused of having a gambling element by

those whose opinions as to what risks are worth while differed from ours. . . . Every transaction of buying and selling necessarily involves a risk. Betting on merely incidental results of particular contests is the assumption of a risk which did not exist before the bet was made. It would seem as if a fair distinction of this kind might be made, speculation being defined as the assumption of inevitable business risks of fluctuating values; gambling as the assumption of purely artificial risks in connection with some fortuitous event." (H. C. Emery, "Should Speculation Be Regulated by Law," Regulation of the Stock Exchange, pp. 830-832.)

(Vb) "When carried on in connection with either commodities or securities it tends to steady prices. When speculation is free, fluctuations in prices, otherwise violent and disastrous, ordinarily become gradual and comparatively harmless . . . For the merchant and the manufacturer speculation performs a service which has the effect of insurance . . . The most fruitful policy will be found in measures which will lessen speculation by persons not qualified to engage in it. In carrying out such a policy exchanges can accomplish more than legislatures . . . We are unable to see how a State could distinguish by law between proper and improper transactions, since the forms and mechanisms used are identical. Rigid statutes directed against the latter would seriously interfere with the former . . . Purchasing securities on margin is as legitimate a transaction as the purchase of any property in which part payment is deferred. We, therefore, see no reason whatsoever for recommending the radical change suggested, that margin trading be prohibited." (Hughes Commission Report of 1909 on Speculation.)

(Vc) In an address "The Work of the New York Stock Exchange in the Panic of 1929" delivered in Boston, June 10, 1930, President Richard Whitney stated:

"A third lesson from the panic is, in my opinion, the necessity of maintaining flexible requirements concerning margins, not only upon security collateral loans, but also upon stock brokers' customers' accounts. It was fortunate that at the beginning of the panic both classes of margins were unusually high. It was equally advantageous during the panic that both classes of margin requirements were drastically reduced. Sometimes students of finance speak as though the sole necessity was always to maintain very high margins. Actually, margin requirements should be flexible, and high or low as circumstances dictate. For precisely this reason I am opposed to legislative enactments compelling inflexible and invariably high margin require-

ments for either loans or customers' accounts. No inflexible law can, in this regard, ever prove an effectual substitute for wise and experienced administration."

(Vd) "Both the writer and the reformer must reckon more than they have done with the fact that speculation in the last half-century has developed as a natural economic institution in response to the new conditions of industry and commerce. It is the result of steam transportation and the telegraph on the one hand, and of vast industrial undertakings on the other. The attitude of those who would try to crush it out by legislation, without disturbing any other economic conditions, is entirely unreasonable." (H. C. Emery—"Speculation on the Stock and Produce Exchanges of the United States," p. 9.)

## CHAPTER VI

### A Typical Investment Transaction

(VIa) In case, however, one buying member had simply cried, "Take it," while another buyer had simultaneously made a definite bid for the stock by saying "(I'll give) 150 for a hundred (shares)," it is a rule of the Stock Exchange that the latter, because he is an actual bidder, shall have the preference and get the selling member's stock. Similarly, after—say—50 has been bid for a stock, if simultaneously one seller cries, "Sold," while another says "(I'll) sell a hundred (shares) for 50," the latter member offering the stock is accorded the sale.

(VIb) In 1929, the increase of the Stock Exchange membership brought upon the floor a considerable number of new members some of whom were inexperienced in the technique of floor dealings. To inform them in this regard, and also to settle occasional disputed points between the older members, a Special Committee of the Exchange after considerable effort codified the practice of the Stock Exchange floor on numerous moot points of dealing, and this code was subsequently published in pamphlet form by the Committee of Arrangements. So essential is this material to a complete grasp of Stock Exchange practice, that it is reproduced in full in this Appendix.

### Dealings in Securities

#### BIDS AND OFFERS

*Precedence on the Floor.* The first bid or offer, at a price for one or more units of trading, entitles the maker to the floor; a sale removes bids and offers from the floor in that classification only (regular way, cash,

seller's option, etc.). Thereafter, the floor is determined by precedence of succeeding bids or offers.

The largest bid has precedence; as an instance, "A has the bid for 100 shares at  $35\frac{3}{8}$ ; B bids  $35\frac{3}{8}$  for 500. C offers 500 at  $35\frac{3}{8}$ ." A is not entitled to buy 100 of the 500.

*Sale of less than a Unit.* A sale of an amount of stock of less than 100 shares does not take a bid or offer for 100 shares from the floor.

*Larger Amounts than One Unit.* In the case of a bidder for 500 shares, one for 200 shares, and one for 100 shares, all at the same price and of equal priority, with 600 offered at the bid price, after supplying the 500 shares, the other 100 of the 600 should go to the bidder for the 200 shares.

In the case of three bidders, each for 200 shares, and a bidder for 100 shares, all at the same price and of equal priority, with 500 offered at the bid price, after supplying two of the 200's, the other 100 of the 500 should go to the odd bidder for 200.

Where a stock sells at 18, and a member bids  $17\frac{7}{8}$ , and no one accepts the bid, and the member then offers 500 at 18, and takes it himself, a claim of another firm, with an order to sell 300 at 18, to share in the 500, is not valid as the 500 share offer has precedence.

Where a member bids for 300 shares of a stock, with two other members each bidding for 100, and another member enters the crowd and says, "Sell both," the 200 should go to the member bidding for 300.

Where a member bids for 100 shares of a stock and a second member enters the crowd and offers 200 at the same price, and the first member says, "I will take them," and a third member says, "Take one," the 200 should go to the first member.

Where there is no dispute regarding a trade except as to the number of shares traded in and neither party can produce a witness, the trade shall be considered to have been for the smaller number of shares.

An order to buy or sell a lot exceeding but not a multiple of 100 shares is subject to Section 8(b) of Chapter I of the Rules.

A transaction of 100 shares or more will be considered as changing the board and as affecting stop orders, and shall be printed on the tape and sheet, and will not be considered as a special transaction.

Where a member, A, has the floor, and, after bidding, his bid is supplied, and he runs the seller up by saying, "Two, Three," etc., up to say, "Five," and if the seller then retires, A's bid, and bids of, say B, C, and D, at the same price, are then on an equal footing.

*Claiming Sale.* Where a member publicly claims a purchase or sale, such claim shall be construed as a bid or offer, and shall carry the rights and liabilities of such bid or offer.

*Stopped Stock.* If A stops 500 shares of a stock with B at 86, and 100 sells at 86, 200 at  $85\frac{3}{4}$  and 200 at  $85\frac{1}{8}$ , unless there is a specified agreement between A and B that A will take 500 at 86, B sells his stock as it appears on the tape.

*Reopening Contracts.* Attention is called to Section 9 of Chapter XIV of the Rules which provides that "No member shall reopen a contract which is subject to a transfer tax for the purpose of allowing another member to



intervene in such transaction, or for the purpose of making a contract in his own interest at a different price."

### ORDERS

*Members should not use messengers or the tubes to transmit important orders and cancellations of orders, but should avail themselves of the service of a broker. This will obviate error and delay.*

Orders for stocks must be sent to the floor promptly, on blanks of the size and style fixed by the Committee of Arrangements, and must be dated and written clearly, especially as to tape abbreviations and prices; amounts must not be written in Roman numerals.

In order to retain precedence, G. T. C. orders to specialists must be confirmed at the end of the month with the specialists. Orders not so confirmed will automatically be cancelled.

*Cancellation.* Where members cancel open orders which have been given to specialists the fact that an open order is being cancelled should be indicated so that specialists with both open and day orders will know which order is being cancelled.

*Reduction of Orders.* On the day a stock sells "Ex-Dividend," the following kinds of orders should be reduced by the amount of the dividend:

1. Open buying orders; 2. Open stop orders to sell.

Not to be reduced. 1. Open stop orders to buy; 2. Open selling orders.

With reference to orders in stocks selling ex-dividend on the first business day of a month, the Committee of Arrangements has ruled that:

"Orders sent to a specialist prior to the close on the last day of the month should be handled the same as any other orders received during the month. Open buying orders and open stop orders to sell, received by a specialist after the close on the last business day of the month or before the opening on the first business day of the following month, should be reduced by him as stated above if such orders are a confirmation or continuance of old orders; but if said orders are new orders the amount of the dividend should not be deducted by the specialist, the responsibility for their accuracy resting upon the member or firm giving said orders, and not upon the specialist."

An order received by mail on the day a stock sells "ex," but before the opening, should be reduced by the member or firm receiving the same by the amount of the dividend.

"At the Opening" or "At the Opening Only." Such an order shall be construed to mean at the opening in that particular stock.

*Member temporarily representing another member or specialist.* The responsibility of a member who is in charge of a specialist's book or of an order from another member, toward such book or order during such time and for the balance of that day, is the same as that of such specialist or other member. (Chapter XI of Rules.) The foregoing also applies to specialists who are working in conjunction on the same books.

*Confirmations.* Commission houses are requested to inform their representatives that they should promptly comply with requests from specialists to confirm trades and that it is their duty to make sufficient inquiry into the condition of the market to fully determine the fairness of the price.



*Market and Limited Orders.* If a member gives a specialist an order to sell stock at a limit and shortly thereafter the specialist receives another order to sell at the market, the specialist should execute the market order below the limited order, except at the opening.

*Receipt Stubs.* Specialists must *promptly* sign and return to the senders the receipt stubs attached to open orders, cancellations, and confirmations of orders.

*Specialists' Facilities.* Every specialist, or a representative authorized to act for him, must remain on the floor every day that the Exchange is open for trading until his reports have been sent out, or for one-half hour after the close of the market, and each firm having a telephone space on the floor must keep at least one clerk on the floor for one-half hour after the close.

*Specialists' Reports.* A specialist using the report pad of another member, or of a firm other than his own, shall have his name placed on said pad in addition to the name of such other member or firm. The foregoing does not apply to members who assist other members temporarily or in an emergency but only to those members who regularly use the pads of other members or firms.

If a member or firm makes a written request of a specialist after the close for a report regarding the execution of an order, the specialist must definitely answer the inquiry before 9:30 A.M. of the following business day.

*Responsibility for Orders.*

1. (a) Where a specialist receives and retains an unaddressed order, delivered by a page or through the tubes, for a stock other than one in which he specializes, the specialist is entirely responsible for any loss that may be occasioned thereby.

(b) Where a specialist receives and retains an order addressed to him for a stock other than one in which he specializes, which is delivered by a page or through the tubes, or is handed to him by a member without the member saying anything in relation thereto, the specialist and the member are each responsible for one-half of any loss that may be occasioned thereby.

(c) Where a member hands an order to a specialist and makes an erroneous statement to the specialist at the time as to the amount, price or name of the stock, the member is entirely responsible for any loss that may be occasioned thereby.

(d) In order for the foregoing propositions to be applicable, the order must be clearly written. If there is any question as to the clearness of the order or designation of the stock, the whole matter is one for arbitration.

(e) When a member trades with a specialist the responsibility lies with the member as to the identity of the stock traded in.

2. In cases brought before the Arbitration Committee it has been the decision of that Committee that if a specialist accepts an order from a member, and the stock sells at or through the limit of the order and is covered by the tape, and the specialist should have executed the order and reported it but has not done so, and the member neglects to ask for a report, the responsibility of the specialist is limited to a fair opening price on the following day.

3. If, by reason of the *neglect* or *inattention* of a member, an order to sell is not executed when the stock sells at or through its price, and the stock declines thereafter, or the reverse, the member should take or supply the customer's stock, as the case may be, at the price of the order, as covered by the tape, in which case he is not acting as a broker, and shall charge no commission.

4. If a reporter has not been received from a specialist on an order which he should have executed, the specialist is responsible for any loss which may be sustained to the opening price of the following day. The member or firm giving the specialist the order is responsible for any subsequent loss unless the order was for the account of an out-of-town member, in which case the foregoing loss should be borne jointly by the New York member and the out-of-town member.

5. If a specialist accepts an order, and later states in writing, or verbally to a member, that the order has been executed, the specialist is responsible for said execution if it has been covered by the tape.

6. If an order is received and executed by a specialist and he reports in writing, or verbally to a member, that the order was not executed, the specialist cannot compel the member to accept a report subsequently.

7. The price at which an order is executed on the Exchange shall be binding, notwithstanding the fact that an erroneous report in respect thereto may have been rendered; and no member shall assume or pay any part of the difference between the price at which an order is executed and the price at which it may have been erroneously reported. (Section 10, Chapter II of the Rules.)

8. A specialist is responsible for all orders which are given by members to any person designated by said specialist to receive orders for him.

*Give-Up* orders received by wire must be confirmed by both parties (see Circular C-1274).

The stating by a party to a transaction of the name of a member or firm, other than the actual contracting parties, is known as a "give-up." (Chapter II, Sec. 8 of Rules.)

Unless a "give-up" is part of the original bid or offer, the brokers who execute the trade are the responsible parties. A floor broker or specialist is responsible to the other contracting party unless the "give-up" is part of the original bid or offer. (Chapter I, Sec. 14 of Rules.)

*On Order.* This term is used when a member has orders from two principals to buy and to sell and not to give up, in which case he must add to his name on the report the words "on order." (Chapter XI, Sec. 1 of Rules.)

*Commissions* must be charged on purchases and sales of securities dealt in upon the Exchange *under all circumstances*, which include orders executed for fellow members during their temporary or other absence from the crowd.

The bunching of selling orders in stocks or bonds by several members, one of said members offering and disposing of the entire lot and not charging his associates in the sale any commission, is contrary to the Commission Law.

Where a specialist or other member has a joint account with another member, members' rates of commission must be charged upon all transactions made for said account.

## QUOTATIONS

*Duty of Members.* It is the duty of the seller to see that reporters receive reports of transactions. Errors or omissions should be promptly called to the attention of reporters. A request for a printing must be initiated by the member making the request.

Except when printed erroneously through mechanical error, an opening or closing, or sale on which other transactions may be based, such as stopped stock and odd lots, or a sale against which any protest shall at the time be made, may not be cancelled or changed without approval of the Committee of Arrangements.

*Stopped Stock* can not be printed on the tape or sheet if objected to by a member.

## TRANSACTIONS NOT APPEARING ON TAPE OR SHEETS

1. No sale making a new high, low, opening or close may be printed on the tape or sheet of a day subsequent to the transaction.

NOTE: Members may have transactions confirmed by the Secretary upon application in writing, giving the date, names of the parties and prices; or if there is a dispute arising therefrom, it should be referred to the proper Committee.

2. Upon request of a member (in the case of bonds through a member of the Bond Crowd Committee) and with the approval of a member of the Committee of Arrangements, a sale not making a new high, low, opening or close may be (a) printed on the tape before 9.45 a. m. of the day following the transaction or (b) printed upon the sheet of any day following the transaction.

3. The only exception to the above rules shall apply in the case of book bonds, and stocks dealt in on a 10-share unit basis, where transactions not appearing on the tape on the day of execution may be printed on a subsequent day's sheet, within seven days of the date of the transaction, provided that the price does not conflict with bids and offers in the cabinets on the day of the transaction, and provided that the member or firm requesting the printing of the transaction signs and files with the Exchange a letter assuming responsibility for any claims that may thereafter be made.

Matters involving the settlement of ordinary questions arising in the course of trading, disputes regarding bids and offers, and requests with relation to the tape, should be referred to the Committee of Arrangements. Questions in regard to any unusual conditions should be referred to the Committee on Business Conduct.

(April 8, 1929.)

(VIc) "The Stock Exchange uses every possible precaution to protect its members in making contracts on its 'floor,' and that such action has been well taken is proven by the confidence shown: as evidenced by the fact, that a man's word in the Stock Exchange is his bond, and nowhere in the world is so vast an amount of business carried on without the use of the written pledge or document, and with such small proportionate loss; and this same protection is ex-

tended to their clients. Negotiability imparts value to securities, and the New York Stock Exchange promotes negotiability." (Duncan MacGregor in the *Financial Barometer*.)

(VIId) The stock ticker was first projected about 1867 by E. A. Calahan, an employee of the American Telegraph Co. Prior to that time, current quotations were made available from the Stock Exchange during the day by a curious industry known as "pad-shoving." Messengers would secure the latest prices at the Exchange, and rush from one brokerage office to another shouting them out. In the days before continuous markets, 40-story buildings, and four million share days, this was well enough. Nevertheless, by December, 1869, the first stock tickers in the world were installed by a few progressive Wall Street brokers. So slow and subject to break downs were they, that for a time the "pad-shovers" competed successfully with them. In a few years, however, perfections in the machines by Thomas Edison and other inventors rendered the occupation of "pad-shoving" obsolete in Wall Street.

The stock ticker, of course, operates much more rapidly than the revolution of the earth. The stock tickers of San Francisco report prices only about a minute after they have been printed in New York. But when the New York market opens at 10 A.M., it is 9 A.M. in Chicago, 8 A.M. in Omaha, and 7 A.M. in San Francisco. When daylight saving time was adopted and the Exchange opened at 9 A.M. standard time, the unhappy Californians protested vigorously at being forced to begin the day's business at 6 A.M. Yet at the same time, the London broker interested in American securities finds it 2.56 P.M., and if he wishes to follow the New York market to its close at 3 P.M. New York time, he cannot leave the "City" for dinner till about 8 P.M. All the New York Stock Exchange can do in this dilemma is to point out that, after all, it is not really responsible for the leisurely pace of the world's sidereal revolution!

Originally, quotations for both stocks and bonds were handled by the same quotation system in the Exchange, and were printed on the same stock tape. In 1919, bonds were placed on a special "bond ticker" in order to relieve congestion on the stock ticker. All quotations were at that time dispatched from the floor by ordinary telegraphic instruments to an office in the upper stories of the Exchange building, where operators received them and printed them on the tape. Only one instrument was needed to send bond quotations upstairs from the floor, and thus the bond ticker system was comparatively simple. But there were four stations on the floor, whence stock quotations were dispatched, and consequently upstairs there had to be four operators



to receive them. In their midst was stationed an operator who printed the stock quotations on the tape by means of an electrical punch-button device, from the written slips handed to him in rotation by the four men receiving quotations from the floor. Naturally, in a busy market, these four men could receive quotations faster than the single central operator could print them. Also, he would in practice seize a bunch of slips from one receiving operator, print them, then seize another bunch from the next operator, and so on. Thus the quotations were not printed in their strict chronological order, with the result that sometimes on the stock tape there would appear "bunched" quotations for one active stock after another. This gave the public the false impression that, in the market, activity went in spurts from one stock issue to another. It also rendered some quotations on the tape still further behind the market. In proportion as stock market activity increased, these defects became pronounced.

After careful testing, a new system for quotation transmission was fully installed on the Exchange in the spring of 1923. The chief feature of this new system was the abolition of the four receiving operators and printing operator, and the substitution therefor of electrical machinery. Today, when the floor operator presses down a key on his instrument, an appropriate impression is made on a mechanical device resembling a Pianola roll. An electrical "interrupter" speedily shifts from one to another of the several sending wires from the floor, and thus largely avoids the old evil of "bunched sales" on the stock tape. Where formerly two persons had had to handle quotations after the floor operator had dispatched them and before they appeared on the tape, now nothing but machinery intervened between the floor operator and the New York Quotation Co. stock tapes. Where the old system had possessed a maximum speed of 225 characters on the tape per minute, the new system now made it easily possible to print 260 characters per minute upon it.

But volume in the stock market continued to grow, and with it the necessity for still speedier operation of the ticker system. The central transmission machinery had been improved, and now the ticker instruments themselves came to constitute the chief factor in limiting the speed of the system, for they could print only about so many characters per minute irrespective of market conditions. During 1927, days of 2,000,000 share sales became common-places, and even "3,000,000 share days" not uncommon. In the spring of 1928, several "4,000,000 share days" occurred, and even one "5,000,000 share day." This great volume of business naturally tested the whole Stock Exchange mechanism, and the greatest difficulty was experienced with



the stock tape which continually ran behind these enormous markets. At length, American inventive genius came to the rescue of the Stock Exchange by producing an entirely new stock ticker machine, capable of printing 900 characters a minute and of handling 7,000,000 share days. But this machine could not be immediately utilized; not only were elaborate tests on a time basis necessary, but the task of installing them all over the country was also great. Furthermore, the new machines could not be operated up to their full capacity until every old machine in the country had been replaced.

In the interim, the attempt was made to speed up the ticker service by using fewer characters to print the same information. Some time before, the ticker symbols for the various listed share issues had been carefully revised, not only to cut symbols of three letters down to two, and those of two down to one, but also to make the one letter symbols as far as possible coincide with the most active stocks. The actual printing of symbols was performed in the old ticker machine by a little wheel, electrically operated, with the various letters on its circumference. To save time taken up by rotation of this wheel from one letter to another, the ticker symbols were also reorganized so as to make the letters of a given symbol come as close together as possible on this wheel.

As of Sept. 25, 1929, there were 9,707 stock tickers and 1,068 bond tickers in operation by the New York Quotation Co., the Western Union Telegraph Co., and (in Boston) the United Telegram Co. They were located in 346 cities in 41 states of the Union and in the Dominion of Canada. Of this total, 5,728 were located in New York State.

Automatic ticker quotations were first completely dispatched to the Pacific Coast in March, 1926. Subsequently, the service was extended to such other distant centers as Dallas, Texas; New Orleans, Louisiana; Atlanta, Georgia; Birmingham, Alabama; Denver, Colorado; Salt Lake City, Utah; Portland, Oregon; Los Angeles and San Diego, California; and Vancouver, British Columbia.

When in 1928 the old stock ticker still was unable to keep up with the market, even more drastic steps were taken to economize characters on the tape. In price quotations, all but the last digit plus any fraction was omitted; thus 300 Steel common sold at 147 $\frac{3}{8}$  which formerly had been printed on the tape "X3.147 $\frac{3}{8}$ " now became "3.7 $\frac{3}{8}$ ." Subsequently, the rule was made that when the tape is five or more minutes behind the market, no volume of sales under 5,000 shares should be reported until the tape has again caught up to the market. Since the bond tape did not become similarly congested, inactive

shares were transferred to it. The proposal has also frequently been made to install a duplicate stock ticker system, and thus place—say—industrial shares on one stock ticker and rails and utilities on the other. The difficulty with this proposal is that it would apparently necessitate a duplication of stock ticker wires all over the United States—an enormous undertaking. The new ticker machine, however, has provided a basic solution to the whole problem.

It was unfortunate that the new ticker machines were not completely in operation during the 1929 panic. During the days when stock sales exceeded 10,000,000 shares, it was impossible for the ticker system to keep abreast of the market. On October 29, when reported sales reached 16,400,000 shares, the ticker did not stop until 5:32 P.M.—two hours and a half after the closing of the market. As President Richard Whitney stated in his address (Boston, June 10, 1930) "The Work of the New York Stock Exchange in the Panic of 1929":

"The Exchange authorities, to relieve this situation, published prices of leading issues at ten minute intervals on its less crowded bond ticker. But this palliative, although useful, was far from sufficient to allay the public confusion. Many sellers of stock were unable to learn the prices at which they had sold, while potential buyers could not learn current prices of shares promptly enough to enable them to make purchases which they might otherwise have been willing to do. The mechanical limitations of the ticker system thus considerably aggravated the public hysteria."

Apart from actual price quotations, the ticker tape is used for several other purposes. Before the "opening" it is tested by the repetition of figures and letters in sequence but without meaning. Also, official notices are printed upon it, such as dates when certain stocks will sell "ex-dividend," or announcements that certain securities will or will not be "good deliveries" on Exchange contracts. New issues just listed will be assigned a new ticker symbol. Notices of suspension of trading are printed there; at 9:55 A.M. on the historic morning of July 31, 1914, appeared the official announcement of the closing of the Exchange. During the 1929 panic, notices concerning emergency measures were similarly released on the bond and news tickers. In this way, the whole financial district can be placed on notice regarding details of the Exchange business, a great facility in standardizing security practices.

The ticker also serves as an alarm clock to Wall Street. At 14 minutes after 2 P.M. "DELIVERY TIME" appears on the tape, after which quotations are suspended temporarily, and fifteen distinct beats follow on the ticker. The last beat marks 2:15 P.M., which is the

limit for delivery of securities on Exchange transactions made the previous full business day.

The ticker is also used as a speedy "lost-and-found" column for the financial district, by printing notices that certain bond or stock certificates have been lost or mislaid. This immediately endangers any attempt by a thief to negotiate stolen securities, by communicating the given certificate numbers to everyone. Sometimes, too, an Exchange broker may fail in the press of active business to catch the name of the buyer; in this case, when the ticker prints "JOHN SMITH SOLD 200 STEEL COMMON AT 140: NO NAME" the buyer will see it, communicate with the seller, and avoid future difficulty.

After the day's quotations, the ticker prints the final bids and offers at the close thus giving the very latest indication as to price conditions in the market that day. High and low prices for the day are then run off on the tape, and finally "settlement prices" from the Stock Clearing Corporation for use of Exchange members in preparing for the clearance and settlement of that day's business on the Exchange.

(VIe) "It has long been known that investors and speculators in America enjoy vastly more safety in their market operations through these various avenues of publicity than do investors and speculators abroad. There are no tickers worthy of the name across the water, and the daily list of business done, as published in our newspapers, with bid and asked prices and total transactions in detail, is unheard of among all the Bourses in Europe. The eminent French economist, Paul Leroy-Beaulieu, speaks very earnestly of the superiority of our New York Stock Exchange system in this matter. He says the need for a similar method in France is 'very urgent,' that the information thus spread broadcast is 'very instructive,' that the pledge of publicity is 'better assured in the United States than in any other country of the world,' and that an immediate reform along these lines is 'absolutely necessary' in Paris in the interest of the public." (Van Antwerp, p. 163.)

(VI f) Particularly with inactive issues but also frequently with active ones, a brokerage customer will wish to ascertain, before giving his brokerage firm a buying or selling order, not only the last sale-price of the given security on the ticker tape, but in addition the current bid and offer prices for it on the Exchange floor. He may therefore request his broker to get him a quotation for it.

Formerly, the brokerage firm, in complying with such requests, would telephone to its floor member on the Exchange, who would have to obtain the request at his floor phone, go to the proper post and get the bid and offer quotations, and return to his floor phone whence they

would be sent to his office and reported to the customer. This plan did well enough in dull markets, but when the floor member was already busily engaged in executing actual orders he would be forced to delay in obtaining quotations in this way. In the very active 1928 markets, it became practically impossible for this reason to furnish prompt and accurate floor quotations. Yet the fact that the stock ticker often was running "behind the market" only increased the demand for them. The Committee of Arrangements took this problem firmly in hand, and on October 1, 1928, inaugurated as a solution to it the present highly satisfactory telephone quotation system. At each trading post on the floor a telephone quotation station was installed in charge of clerks who, as market prices change, telephone bid and offer quotations for the securities listed at that post by private wire to the operators at quotation desks in a newly established central quotation room in the upper stories of the Stock Exchange building. These quotation desks are connected by telephone wires through switchboards to the order rooms of Stock Exchange offices in New York.

By means of this system, a Stock Exchange office desiring bid and offer quotations can call from its order room to the operator in the central quotation room who is in contact with the floor quotation clerk at the particular post where the given issue is listed. In this way, Stock Exchange firms can ascertain bid and offer quotations speedily and accurately.

## CHAPTER VII

### Credit Transactions in Securities

(VIIa) The complete collapse and destruction of certain East European currencies after the war temporarily compelled a reversion to the primitive practice of bartering goods against goods without the use of money. When, for example, the old Austrian krone became worthless in foreign countries, Austrian manufacturers could not obtain needed raw materials from outside nations except by payment in terms of the goods which they proposed to manufacture. Austrian textile manufacturers would thus turn into cloth the bales of cotton furnished to them by English exporting houses, pay off the latter for the raw cotton with part of the goods manufactured, and earn other expenses and profits by selling the remainder of the cloth. Similar transactions occurred in Germany, Russia and other countries whose currency had been hopelessly inflated. Such reversions to barter of course illustrate how basic barter is to trade, and how fundamental are the situations where debts are contracted and paid in terms of goods rather than in terms of money.



(VIIb) The fluctuations in the value of money become most apparent when the money side of a sale is shifted from the currency of one nation to that of another, at the prevailing rates for the foreign exchange involved. When in the spring of 1920 the German mark rose for a time from  $1\frac{1}{2}$  to  $2\frac{1}{2}$  cents, many German exporters who had purchased goods on credit from German producers for foreign delivery and who had, consciously or unconsciously, gone short of money in so doing, suffered severe losses.

To take an imaginary but quite typical instance, a German export house, let us say, had purchased a consignment of potash from a German company for 400,000 marks, paying 100,000 marks (or a 25-point margin) down on the transaction. This potash the German exporters agreed to sell to an American firm in New York for \$7,500—the equivalent of 500,000 marks at the rate of exchange (1 mark =  $1\frac{1}{2}$  cents) then prevailing. The German exporters naturally expected a profit of 100,000 marks in the sale. But, as has been pointed out, the German exporters were forced to go short of money at the same time they bought the potash on margin. During the time elapsing between the receipt of the potash by the German exporters and its delivery by them in New York the value of the potash does not change, but the value of the German mark rises from  $1\frac{1}{2}$  to  $2\frac{1}{2}$  cents. Observe the result. The \$7,500 paid by the American house is exchanged at  $2\frac{1}{2}$  cents per mark for only 300,000 marks, instead of 500,000 marks expected under the old rate of  $1\frac{1}{2}$  cents. In consequence of this rise in marks, of which the German exporters had gone short, the latter not only do not make their expected profit of 100,000 marks, but in addition lose their margin of 100,000 marks and are barely able to pay the German producers the 300,000 marks still owed to them.

(VIIc) Before the establishment of the Federal Reserve system, the call loan market on the New York Stock Exchange constituted the only central liquid factor in American banking. During a banking crisis, American banks would, therefore, almost unanimously "call their loans," to place themselves in liquid position. The remarkable thing about this old system was that the call loans were always so safe from the lenders' standpoint. But the maintenance of such safety imposed a terrible burden and risk upon the borrowing brokers and their customers, and on call loan interest rates. Few cases ever occurred where a Stock Exchange member could not in the long run get a loan on good securities. But the interest rates soared in the process to sometimes fantastic figures. In the panic of 1907, a few loans were even made at 125% per annum! Needless to say, however, these were retired in a few days.



After the war, the first money shortage since the foundation of the Federal Reserve system occurred in 1919-20, due to congestion of unsold Liberty Bonds in the banks and enormous mercantile and manufacturers' loans employed to carry huge inventories at high prices. The stock market broke in November, 1919, when even 32% was charged on a few call loans. During subsequent months, call money renewed at rates from 10% to even 15%.

During 1928-29 the mounting totals of loans on securities, together with the restrictive credit policies of the Federal Reserve system, led to very high call loan rates. But there was not an actual shortage of credit, owing to the great unused potentialities for expanding credit still possessed by the Reserve system, as indicated by its high reserve ratios. Actually, the 1929 panic broke out when call money had become relatively easy, and during the panic no credit shortage was felt. After the panic, credit at once became extraordinarily easy and interest rates fell to the lowest levels in years.

(VIIId) Corners, like money shortages, are relative rather than absolute, and sometimes it is difficult to state just where they begin. Most corners are really accidental in origin. If each Stock Exchange commission office (including branches) should at one time sell only 100 shares of a certain stock short, a total "short interest" of about 1,200,000 shares could thus be created. This imaginary situation also leaves out of all account the large number of non-member firms who are correspondents of Stock Exchange houses. If only 1,000,000 shares of the stock were outstanding or available for delivery on the Exchange, a technical corner would thus be created without any anticipation of it by anyone. This is the reason why very large issues of stock are more immune from corners than small issues.

The test of a corner on the Exchange is whether the given stock can be freely borrowed. If so, the free and open market has not been destroyed. The Business Conduct Committee may investigate the case, by calling on Exchange members to report to it at once their several positions and commitments in the issue. If no one is attempting unfairly to exploit the situation to his own advantage, the stock will not be stricken from the list and the situation will as a rule soon right itself by the ordinary course of market purchases and sales. As a general thing, company officials have no desire to see their stock cornered, even if they are nettled by previous price declines due to short sales, and almost always they cooperate fully with the Stock Exchange in maintaining a free market for their issues.

Occasionally, however, either persons connected with the management of a company or operators entirely outside its management may

consciously try to bring on a corner in order to extort very high prices from traders who are short of the stock. In this case they will usually wish to halt lending of the stock, and indeed purchase further amounts of it at exaggerated figures in order to secure the corner. The Stock Exchange has several methods of proceeding in such cases provided by its Constitution, including the deferring of deliveries on sales and the power of establishing settling prices. But in extreme cases, it can always strike the stock from its list, on the basis that the "free and open market" for the issue has effectually been destroyed and that further Exchange trading in it would represent only manipulation and unfairness.

In the early history of the New York stock market corners were fairly frequent phenomena—mainly because stock issues at that time were generally so small. Like money shortages, corners have become infrequent with the passage of time, which has brought with it larger issues and better market organization. Probably the most famous corner in the history of the market occurred in Northern Pacific in 1901. So famous was this episode that details concerning it need not be repeated here.

Since the war there have been only two serious corners on the Exchange—that in Stutz Motors in 1920, and that in Piggly Wiggly Stores in 1923. A brief résumé of each will be given here.

The Stutz Motor Car Co. in 1920 had 100,000 shares of capital stock, which were listed on the New York Stock Exchange. The Business Conduct Committee, noting the character of trading in this stock, called before it Mr. Allan A. Ryan of the Stock Exchange firm of Allan A. Ryan & Co. Mr. Ryan stated that he owned 80,000 shares of Stutz, and that he and his family, friends and associates owned or had contracts calling for the delivery to them of stock aggregating 110,000 shares—or 10,000 shares more than the company's total capital stock. The Committee informed Mr. Ryan that he alone was in a position to put an end to this corner, and must take whatever steps were necessary to do so. Subsequently Mr. Ryan stated prices at which he was willing to settle, varying from \$500 to \$1,000 a share. Since the Committee knew that a corner existed in the stock (which the public did not necessarily know), and that a free and open market for the stock no longer existed on the Exchange, to protect the public it followed its usual procedure in such cases and suspended dealings in the stock on the Exchange. This suspension of dealings did not of course affect the legal rights of the parties under any existing contracts. Settlement of these contracts occurred outside the machinery

of the Exchange. Ultimately the stock was stricken from the list, and Mr. Ryan withdrew from membership in the Exchange.

The corner in Piggly Wiggly Stores Class A stock was obtained, not by a Stock Exchange member but by the head of the company, Mr. Clarence Saunders. The Business Conduct Committee investigated the distribution of the stock among its member houses, owing to peculiarities in the price movements of the stock, which was being sold by the company outside the Exchange at prices below that obtaining on the Exchange. The answers to the questionnaires sent to Exchange members accounted for only 39,802 out of 200,000 shares altogether; of these 33,025 were held by Mr. Saunders and other directors of the company. The amount of stock due on loans and open contracts was 13,662 shares. Mr. Saunders declared to the Exchange his intention of maintaining a free and open market in the stock on the Exchange by lending any amount of stock desired without premium. Later the Exchange was notified that the advertising campaign to sell the stock outside the Exchange which the company was conducting, would be discontinued. But the next day Mr. Saunders suddenly called for delivery of his stock, which in turn precipitated the calling of all loans of the stock made previously by Mr. Saunders and his associates. The amount of stock involved far exceeded all the stock in the market other than that held by Mr. Saunders and other directors of the company. The enforcement of contracts simultaneously for the return of stock in this way would have forced it to any price which might be fixed by Mr. Saunders, and competitive bidding for the insufficient market supply might have brought about an acute though temporary "corner." The same day the Governing Committee accordingly adopted a resolution suspending dealings in the stock, pursuant to the provisions of the Exchange Constitution. Also, the Stock Clearing Corporation in accordance with its rules, suspended the delivery of the stock due at 2:15 the next day. Mr. Saunders offered to settle with the shorts for \$100 per share, and later raised this price to \$1,000 per share. But a few days later, upon the date set by the Stock Clearing Corporation, all stock deliverable upon security balance orders was delivered prior to the settlement hour. Thus, the alleged "corner" was more psychological than actual, and Mr. Saunders received all of the stock due him at prices which he contracted to pay for it. He had "cornered" merely the floating supply and not the outstanding issue, and when stock held out-of-town was, through the deferred delivery, permitted to come into the market, the "corner" rapidly broke down. Meanwhile the Stock Exchange struck the stock from its list.

(VIIe) In the panic of 1929, constant rumors of "bear raids" prompted an investigation by the Exchange. Concerning this episode President Richard Whitney (in his address "The Work of the New York Stock Exchange in the Panic of 1929" in Boston, June 10, 1930) stated:

"For a number of days prior to November 12th, there had been constant rumors of tremendous bear raids in the stock market. Such rumors, as a matter of fact, almost always accompany periods of security liquidation. The Stock Exchange authorities nevertheless wished to verify the accuracy of these rumors, and early in the morning of November 13th called upon its members to report to our Business Conduct Committee as of the close of business on the 12th, their position in regard to borrowed and loaned stocks, and other particulars which would speedily indicate the existence of a large short position. These questionnaires to Stock Exchange houses were rapidly analyzed, and it was found that the aggregate amount of borrowed stock was so small as to be almost inconsequential, being, in fact, only about one-eighth of one per cent. of the value of all stocks listed on the Exchange. It is interesting in this connection to realize that November 12th, as of which this study was made, marked practically the lowest point to which the daily stock price indices fell during this whole period. . . . In general the extraordinary absence of bids for the purchase of stock throughout the panic would indicate an absence of a sufficient short interest to give the market its ordinary stability. If early in the fall a large short interest had accumulated, presumably stock prices would never have reached the great heights they did before the panic, and also added buying power during the panic would have been afforded by short covering."

(VIIf) Many practices in finance as well as commerce which are legitimate and economically useful in times of peace, may prove illegitimate and harmful in wartime. Unlike conditions a century ago, modern warfare demands not merely the mobilization of special fighting forces, but the exclusive organization of all industrial and financial effort as well. So it has been with the short sale. During a war, stock market declines may be interpreted as national fears of military defeat, and the short-seller may injure his country by actions in which, purely from an economic basis, he should ordinarily be encouraged.

At the outbreak of the European war, the leading stock exchanges of London, Paris, Berlin, and New York all closed completely by July 31, 1914. Subsequently, New York reopened in December, 1914, London on January 4, 1915, Paris on September 27, 1915, and Berlin on December 3, 1917, for shares and September 1, 1919, for bonds.



But in the three European markets only cash dealings were allowed on the reopening, and term settlements (by which short sales are made there) were forbidden until May 22, 1922, in London, January 2, 1920, in Paris, and October 1, 1925, in Berlin. Owing to this war-time ban on term settlements, further and specific limitations on short-selling in these markets were unnecessary.

But in New York, accustomed to handling short sales on a cash settlement basis, special restrictions on short selling *per se* were considered necessary, and were imposed by the New York Stock Exchange itself. On November 1, 1917, the Governing Committee passed a rule that all Exchange members must report in a sealed envelope daily the amount of their short sales and the names of the persons for whom they were made, and also the amount and names of stocks borrowed. Both Exchange members and their customers were placed on notice that if "bear raids" in the stock market were attempted, the Exchange would at once make public the names of the short-sellers. This system bore excellent results; while "bear raids" were effectually prevented, at the same time the function of the short sale in providing a cushion for declining prices—a particular necessity during the uncertain years of the war—was not destroyed.

(VIIg) The question of the legitimacy of short sales is almost as old as the question of speculation itself. At the present time, short sales are permitted on all the leading stock exchanges of the world, although in Paris and also Milan the buyer is entitled to demand under certain conditions a delivery of securities earlier than that specified in the term-contract by which the short sale is effected. Even the hostile Pujo Committee (1913) stated "there seems no greater reason for prohibiting speculation by way of selling securities in the expectation of buying them back at lower prices, than by way of purchasing them in the expectation of at once reselling them at higher prices." (Pujo Report, p. 52.)

In British experience, the first anti-short sale legislation was the so-called Sir John Bernard Act of 1733, which was in practice disregarded for over a century and eventually repealed in 1860. British legislation against short sales thus narrowed down to the Leeman Act, which prohibited only the short sale of bank shares; this was done upon the curious theory that short selling of such shares might cause runs on the respective banks. There is considerable testimony on this score in the Royal Commission Report (#1178-1184, p. 43). Mr. Spurling, a prominent London broker and money-lender, testified before the Commission that the failure of London banks in 1866 was not due at all to the short sale of their shares, but resulted inevitably



from their weak or worthless assets. Mr. C. J. Furlonger, a London dealer in bank shares, also testified that 1864-65 had seen a great and unhealthy rise in bank shares; that the subsequent price-collapse in these shares was due to the unjustified extent of this rise rather than to short sales; that the short sales of sound bank shares only resulted in losses to the sellers; that bank failures were due to poor management of the banks themselves rather than to short sales; that the Leeman Act all through this period had been utterly disregarded; and that had the Act been enforced, it would only have rendered bank shares practically unsalable. Evidence of similar character in regard to the short sale was furnished by the *Economist* in 1922 when the London Stock Exchange resumed its term settlement, and thereby practical facilities for short selling, for the first time since the outbreak of the war in 1914.

French experience closely resembles that of England. Napoleon's able financial minister, Tallien, for a while succeeded in dissuading his imperial master from forbidding short sales on the Bourse, although this was finally done early in the 19th century, but repealed in 1885 when its harmful nature was realized. The limitation upon French short sales already alluded to has, however, been retained in the French statutes. Italian legislation in this respect has imitated the French precedent.

Germany provides the classic case of the futility and harm of anti-short sale legislation; this has been extensively alluded to throughout the present study. Most fruitful sources are H. C. Emery's articles: "Ten Years' Regulation of the Stock Exchange in Germany" (*Yale Review*, May, 1908, and reprinted in "Regulation of the Stock Exchange," p. 822); and "Should Speculation be Regulated by Law?—Lessons from German Experience," *ibid.*, p. 830-838). There is also a large German controversial literature on this whole subject, from 1893 to 1910.

In regard to the experience of New York State, it was stated in "Regulation of the Stock Exchange" (p. 801): "The legislation of the State of New York on the subject of short selling is significant. In 1812 the legislature passed a law declaring all contracts for the sale of stocks and bonds void unless the seller at the time was the actual owner or assignee thereof or authorized by such owner or assignee to sell the same. In 1858 this act was repealed by a statute now in force, which reads as follows:

"'An agreement for the purchase, sale, transfer, or delivery of a certificate or other evidence of debt, issued by the United States, or by any State, municipal or other corporation, or any share or interest in

the stock of any bank, corporation, or joint stock association incorporated or organized under the laws of the United States, or of any State, is not void, or voidable because the vendor, at the time of making such contract, is not the owner or possessor of the certificate or certificates or other evidence of debt, share, or interest.' ”

## CHAPTER VIII

### The Floor Trader and the Specialist

(VIIIa) The necessity of dealers to “make a market” is recognized by all leading stock exchanges except the Paris Parquet where, because of the unique governmental monopoly in stock brokerage which they possess, the Agents de Change are forbidden to deal for themselves and are brokers pure and simple. This does not mean that dealers are absent from the Paris official market, for floor clerks of the Agents and also outside parties operating through the Agents de Change can, of course, buy and sell for themselves. Nevertheless, this rigid system, however in accordance with the peculiar conditions of the Paris market, makes the speedy and dependable execution of orders on the Parquet much more difficult than in London or New York, where stock exchange members acting as dealers are constantly on the floor and ready at practically all times to make an immediate market in any amount of any listed security themselves.

(VIIIb) The New York Stock Exchange has issued three studies in pamphlet form upon the stock sales tax. The first two, issued in 1920 when it was proposed in Congress to raise the tax, were entitled “The Effect of Taxing Stock and Bond Sales” (a publication of the former Committee on Library of the Exchange) and “In re H. R. 14157” (a brief by counsel for the Exchange).

In 1926, on the occasion of the Congressional revision of American internal revenue schedules, the Exchange made a comprehensive study of the tax, which was published under the title of “Memorandum submitted to the Ways and Means Committee of the House of Representatives and the Finance Committee of the U. S. Senate on behalf of the New York Stock Exchange, praying for the repeal of the stamp tax on the sale or transfer of stock as embodied in Public—No. 176—68th Congress (H. R. 6715), Title VIII, Schedule A, Paragraph 3.”

In summary, the Exchange’s principal arguments for the repeal of the tax were that the tax is and always has been reserved for war-emergencies, and never before has been maintained in effect so long after a war-emergency has passed; that the tax is actually paid, not

by stock brokers or by dealers in stocks, but by investors all over the United States, and particularly by small investors; that the tax in its present form falls inequitably upon different stock transactions—a defect which cannot be practically remedied; and that the tax impairs the mobility of American capital and the American machinery of credit—a result carefully avoided in the less wealthy but competitive European centers of credit.

In this country, a Federal stock sales tax has been in force during the years 1794-1800, 1812-18, 1862-70, 1898-1902, 1914-16 and 1917 to date. Similar taxes on stock sales and transfers by states of the Union were inaugurated in 1905 by New York State, in 1914 by Massachusetts, and in 1916 by Pennsylvania.

The U. S. Internal Revenue receipts from the Federal tax on stock transfers will be found in Appendix IIb.

Stock-brokers, of course, pass the tax back directly to their customers; this practice indeed is compulsory under the Constitution of the Exchange. Dealers in stock indirectly yet effectually do the same thing by widening the "span" between prices at which they will buy and will sell. Thus the burden of the tax really falls upon investors.

The tax is based upon a 2 cents per share charge on each share of \$100 par value, and, scaling down, 1 cent per share of \$50 par value,  $\frac{1}{2}$  cent per share of \$25 par value, etc. No-par shares are arbitrarily taxed at the rate of \$100 par shares. These taxable values have in practice little relation to market values, and thus many serious inequalities in the tax rates arise. Recently two \$100 par shares were taxed just alike, though one sold in the market for \$1,400 per share and the other for \$5 per share.

Comparison with European stock sales or transfer taxes establishes the following facts: (a) taxes on the American security dealer are the highest in the world; (b) America is the only country which taxes the professional security trader as heavily as the investor; (c) while the American investor seems to be taxed lightly, his burden is really heavy because of the indirect burden of the tax upon the dealer which is shifted to him. Abroad, the tax as it applies to dealers is light enough to be absorbed by them, thus freeing investors from this heavy indirect tax burden.

European security taxes, however, differ considerably from ours, not only in respect to rates, but also to the particular security operations upon which they are imposed. The British tax corresponding to our stock sale and transfer tax is imposed upon the transfers of registered issues, but not upon their sale; it is always referred to as the "transfer tax." The British have established a compensating tax

upon bearer securities which is based upon their issuance. The only real sales-tax on securities in Great Britain is a trifling and unimportant documentary stamp tax imposed upon stock-brokers' "contract notes," (or "confirmations" as we would term them in New York).

The French stock sales tax (*droit de timbre sur les opérations de Bourse*) is imposed upon both purchases and sales of all French securities on a French stock exchange; it applies to cash and term bargains alike, but at half rates to continuations of term bargains. French and foreign securities are taxed alike, except that French rentes enjoy in all cases specially low rates.

Similarly, in Germany, the "Stock Exchange turnover tax" (*umsatzsteuer*) is imposed upon all sales or purchases of securities upon the German stock exchanges; it comprises a complex schedule of rates varying according to the class of securities involved, and to the classes of brokers and dealers effecting the given sales or purchases.

In Holland, the similar tax applies to both the purchase and sale of both stocks and bonds; it applies, however, only to public customers who are the ultimate buyers and sellers of securities, and not to sales or purchases by members of the Amsterdam Stock Exchange.

In Italy, in order to be legally recorded, every security contract must involve the exchange of special slips (*fissati bollati*) which are subject to government tax. This tax varies in rate according to the term of the contract, and according to the occupation of the contracting parties; it is halved when the transaction has been in Italian government issues, or in those guaranteed by the Italian State.

In Austria the "securities turnover tax" (*effektenumsatzsteuer*) applies in general only to transactions on the Stock Exchange, and to those effected off the Exchange through the intermediation of a professional dealer in securities. Ordinarily, the tax is paid only by the seller, but when the transaction is between stock dealers and non-dealers, the former must pay; also, in transactions concluded on the Stock Exchange and settled through the Wiener Giro-und Kassenverein, each party pays half the tax. Transactions in both bonds and shares are taxed, with a half-rate upon bonds of the Republic of Austria or its provinces, districts, and municipalities and upon a few other securities.

Professor E. R. A. Seligman, probably America's greatest student of the economic effects of taxation, has stated in "Incidence of Taxation" (New York, 1921, pp. 381-385):

"Where the net result of a tax on transactions is a decrease in the transactions, the real burden may be regarded as falling on neither



the seller nor the purchaser. It is an instance of the effects of a tax being injurious to those who do not pay it, rather than to those who pay. In so far as the parties to the transaction are concerned, the result of the decrease of sales of real estate, for instance, is to lower the selling value of the land. For any impediment to the free transfer of a commodity is bound to diminish its relative desirability or value. The purchaser indeed pays the tax but he will recoup himself by paying so much less for the land. Were there no tax he would be willing to pay a larger price. The result hence is that the tax is capitalized or amortized into a lower selling price of the land and it is only the original owner who possesses the land before the tax is imposed or increased, who suffers. After the tax has been in existence long enough for the original owner to part with his land, the new owner as a consequence of the absorption of the tax will not suffer.

"This kind of capitalization or amortization, however, differs from the ordinary phenomenon discussed above. For ordinarily capitalization depends on the regular recurrence of a tax and can be ascertained by the simple arithmetical process of capitalizing the difference between the present and the future income. In the case, however, of taxes on the transfer of real estate, while the tax indeed recurs, the recurrence is at irregular intervals and the depreciation consists in the capitalization of an unknown quantity. This very uncertainty contributes to render real estate values unstable and in itself would suffice to explain the absence in France of such an important class of operators as the "real estate interests" in large American cities.

"The same considerations which have just been mentioned apply, with some modifications, to the taxes on stock- and produce-exchange transactions. The process, however, is even more subtle and complicated.

"The ordinary view of such taxes is that they are borne by the respective parties in interest—the buyers and sellers of securities or the speculators on the bull or the bear side in produce so that the tax may really be considered as a tax on speculation or on the unearned or fortuitous profit of the speculator. A tax on stock- and produce-exchange transactions would thus be a tax on speculative profits.

"In reality, however, it is nothing of the kind. The results are quite different.

"The real function of speculation, as has been abundantly shown by modern economists, and as has recently been explained in detail in the admirable report of the special commission on the exchanges



appointed by Governor Hughes of New York, is to afford a continuous open market for the transactions and thus to diminish the fluctuations of price. Any attempt to restrict legitimate trading is bound to interfere with this steadying influence. Thus the famous prohibition of speculation in gold during the Civil War in the United States resulted in immensely increased oscillations of price which continued until the hasty repeal of the law; and the recent German legislation against futures in the wheat market produced an effect the contrary of what was anticipated, leading, after the lapse of a decade, to an alteration in the law. A tax on produce-exchange transactions would tend to have the same kind of effect as an absolute prohibition although its efficacy would obviously be far less. In other words, a tax would tend to diminish the number of transactions or to restrict the market. To this extent it would lead to an increase in oscillations of price. But the tax, although paid by the broker, would be charged to the principal, whether seller or purchaser, and would not be borne by this principal; for as long as he continued to speculate, the gains on the larger margins of the fewer transactions would presumably equal the fewer gains on the smaller margins of the more frequent transactions. The real burden would be borne not by the speculators but by the producers or the consumers of the commodity traded in on the produce exchange. For the advantages of the relative stability of price due to produce speculation inure, as is well recognized, either to the producer or to the consumer, or to both. The price on produce-exchange transactions tends, therefore, to engender consequences which are not usually expected. Where, indeed, as is commonly the case, the tax is relatively slight, these consequences are almost imperceptible. But at all events the tax must not be regarded as one on speculators' profits.

"In the case of stock-exchange taxes, the situation is still more complicated by the fact that we are not dealing so directly with producers and consumers of a taxable commodity. The tax is imposed on the transfer of securities, not of ordinarily consumable commodities. Here again it may be stated that the tax is not, as usually imagined, borne either by the brokers or by their immediate principles who are trading on margins. For here, as on the produce exchanges, any hindrance to the free speculative movement tends to increase the fluctuation of prices, and with this widening of the upper and lower limits of stock quotations even the so-called traders or room brokers in New York, who virtually speculate on their own account, will tend, notwithstanding the diminution in transactions, to make as high profits

as before. The real burden here falls, not on the parties to the transactions, but on certain outsiders.

"Who are these outsiders? In the first place, they are apt to be the smaller capitalists who have borrowed on securities and who are less able to endure the losses resulting from excessive declines in value than are their larger brethren. In the second place, since the tax increases *pro tanto* the expense of transferring securities and thus diminishes the mobility of capital, it is likely to increase, even though slightly, the rate of interest. If, however, the rate of interest rises the capital value of the securities will decline. We would thus have a kind of capitalization of taxation somewhat comparable, although not in degree, to the capitalization brought about by a tax on the securities themselves. If, however, instead of dealing with a new or suddenly increased tax on stock-exchange transfers we have to do with a long and well established tax, the net results will obviously be that when the securities are initially listed on the exchange they will fetch a price somewhat lower than would be the case were there no tax on the stock-exchange transaction. The real losers, therefore, will be the bankers who float the securities; or, still more likely, the corporation or enterprise which has arranged with the promoters to underwrite the issue. The ultimate result will be a slight falling off in the profits of the stockholders in the industrial and other enterprises whose securities are listed on the exchanges; and to the extent that the issues consist of government bonds, a slight increase in the public expenditures, which is, of course, far more than compensated by the proceeds of the tax, when the same government that issues the securities also imposes the tax. Thus here again we see that the consequences of a tax are frequently quite different from those that are expected or intended."

Again, in "The Effects of Taxation," in the *Political Science Quarterly* for March, 1923 (p. 23), Professor Seligman stated:

"The indirect consequence of a tax may be far greater than the direct effects. An excessive tax on business enterprises may not only cut down business profits but lead to such a reduction of employment and wages that it will be borne by classes of the community far removed from the direct taxpayers. A tax on stock exchange securities by hindering the free speculative movement may cause a widening of the upper and lower limits of stock quotations so that when the new securities are initially listed they will fetch a smaller price. This will obviously cause the bankers who underwrite and float the securities to make a bargain more unfavorable to the corporation or enterprise in question. When we are dealing with private issues

of securities the effect will be a diminution in the profits of shareholders; to the extent that the issue consists of government bonds, the effect will be an increase in public expenditure with all its attendant consequences. The ulterior effect of even a simple tax may be profound."

(VIIIc) When one member of the Exchange (usually a commission broker) gives an order to another member to execute, the latter (usually a specialist or "two dollar broker") obtains from the former a commission for his services based upon the schedules of minimum rates established for such transactions in the Constitution [Article XIX, (b) and (c)].

When the giver of the order does not give up his own name as a principal in the transaction and has the member executing the order clear it for him, the higher schedule of rates (b) applies; when he does give up his own name as a principal and clears the transaction himself, the lower schedule of rates (c) applies. These two schedules are as follows:

| Prices per Share                                    | Minimum Rates per Share |                        |
|-----------------------------------------------------|-------------------------|------------------------|
|                                                     | (b)                     | (c)                    |
| Selling under 50¢.....                              | (As mutually agreed)    |                        |
| Selling at 50¢ and above, but under \$1.00.....     | $\frac{3}{4}\text{¢}$   | $\frac{1}{2}\text{¢}$  |
| Selling at \$1.00 and above, but under \$10.00..... | $1\frac{3}{4}\text{¢}$  | $1\frac{1}{4}\text{¢}$ |
| Selling at \$10.00 and above, but under \$125.00... | $3\frac{3}{4}\text{¢}$  | $2\frac{1}{2}\text{¢}$ |
| Selling at \$125.00 and above.....                  | 5¢                      | 3¢                     |

(VIIIId) "Chapter XI. *Members Dealing for Their Own Account.*

"SEC. I. No member, while acting as a broker, whether as a Specialist or otherwise, shall buy or sell directly or indirectly for his own account or that of a partner, or for any account in which either he or a partner has a direct or indirect interest, securities the order for the sale or purchase of which has been accepted by him or his firm or a partner for execution; except as follows:

"[Exception (a).] A member who, by reason of his neglect to execute an order, is compelled to take or supply on his own account the securities named in the order, is not acting as a broker, and shall not charge a commission;

"[Exception (b).] A member may take or supply the securities named in the order provided the price is justified by the condition of the market and provided that the member who gave the order shall directly, or through a broker authorized to act for him, after prompt notification, accept the trade and report it;

"[Exception (c).] A member, acting as a broker, is permitted to report to his principal a transaction as made with himself when he

has orders from two principals to buy and to sell and not to give up, such orders being executed in accordance with Section 13 of Chapter I, in which case he must add to his name on the report the words 'on order.'

"SEC. 2. When a member either takes the book of a Specialist temporarily or an order from another member, he shall, while he is in possession of that book or order and for the balance of that particular day, stand in the same relationship to the book or order as the Specialist or other member himself."

(VIIIe) The provisions in the Rules of the New York Stock Exchange relating to this phase of members' operations are as follows:

Chapter I. Sec. 13 (p. 80) "When a member has an order to buy and an order to sell the same security, he must offer such security, if bonds at  $\frac{1}{8}$  of 1%, and if stocks at  $\frac{1}{8}$  of one dollar, higher than his bid before making a transaction with himself, if not so already bid or offered."

(VIIIf) The following sequence of events is typical as a cause of misunderstandings arising from the use of orders "on stop." Commission broker A—let us say—obtains an order from his customer, Jones, to sell 100 shares of a rather inactive stock at the market. When A arrives at the post where the given stock is traded in, it is quoted "63 bid, 68 asked." A says to the specialist B, "I have a market order to sell." B replies, "I want 200 at 63. I'll stop 100 with you," (i.e., if a sale is publicly made at 63, A and B will conclude a private sale of 100 shares at that price). A moment later broker C enters the crowd and offers 200 shares for sale. B says to him, "I am bidding for 100 (the remaining 100 of his original 200 shares to buy). I also have a market order to sell, so that no matter what you offer your stock at, I must offer it  $\frac{1}{8}$  lower."

Under the circumstances C says, "I will sell you 100 at 63," to which B agrees. On this sale the order on stop between A and B is also executed. Thus, A sells his stock at 63, and B purchases his 200 shares at that price. But since the order on stop is a private transaction it is not printed on the tape and only C's sale of 100 to B is regarded as "100 shares at 63." The market then becomes stronger and C's order for the remaining 100 to sell is canceled. Soon D comes into the crowd and concludes a sale with E at 64.

Meanwhile, A's customer, Jones, watches the tape. He sees the quotation 100 at 63 (made on C's sale to B), and not understanding that orders on stop are not recorded there, takes it for his own. If the market had continued to decline, he would consider himself



fortunate to have received 63 for his stock. But when he sees the next sale at 64 he becomes suspicious. He concludes that the specialist B must have himself bought his 100 shares from A at 63 and later sold them at 64. And thus, although the specialist really did nothing of the kind, Jones becomes very indignant with him and considers that he has been cheated.

(VIIIg) Prior to 1928, when the great activity of the stock market and the consequent tardiness of the stock ticker sometimes made it necessary to omit the amount of reported stock sales, this amount had always been printed on the tape along with the price quotation, and has afforded security buyers very useful information. From such amounts of sales reported on the tape, the leading metropolitan newspapers have been accustomed to compile their familiar statistics of "Sales on the Stock Exchange" each day.

Yet it must always be borne in mind that the essential purpose of the stock ticker is to report current prices, and that statistics as to number of shares sold are merely incidental thereto. Also, the mechanical limitations of the stock ticker machine have prevented the printing of absolutely all transactions on the Exchange. Therefore, the principle has always been followed of printing on the tape only those transactions which resulted from open market bidding and offering, and in the establishment of new current open-market prices; transactions whose prices were established merely on the basis of current open-market prices have thus been omitted as an unnecessary duplication of prices. But in this process, the volume of dealings attending such omitted quotations is, of course, also omitted from the tape.

The two chief classes of such omitted transactions are "stopped stock" whose price is based directly upon some other price established in the open market, and "odd-lots" whose price is usually based  $\frac{1}{8}$  or  $\frac{1}{4}$  away from the next 100 share open-market price (see Chapter IX). It is estimated that, on the average, the volume of odd-lot transactions constitutes about 30% of share sales reported on the tape, and the volume of stopped stock transactions an additional 5 to 10%. Thus, for a day when share sales reported on the tape aggregated 3,000,000 shares, the actual total of shares sold on the Exchange would probably be between 4,150,000 and 4,300,000.

(VIIIh) Despite the expanded facilities made available for specialists on the Exchange floor, the huge volume of dealings during the 1929 panic caused serious congestion in their work—as indeed in practically all other branches of the Stock Exchange system. Spe-



cialists frequently experienced difficulty in securing accurately the names of brokers with whom transactions were made, with the result that a great mass of so-called "don't know" contracts rapidly accumulated. In order to clear up these and other kindred misunderstandings, specialists were compelled to be at their posts on the floor Friday and Saturday, November 1 and 2, when the Exchange was closed, and for the first time in history all the morning of Sunday, November 3.

## CHAPTER IX

### The Odd-Lot Business

(IXa) In his address (Boston, June 10, 1930) entitled "The Work of the New York Stock Exchange in the Panic of 1929," President Richard Whitney stated concerning odd-lot transactions during the crisis:

"Toward the close of the memorable day of October 29th a rally in share prices began which continued strongly through the 30th and the 31st, and which marked a new and significant phase of the panic period. After days of decline that had seemed endless, the upward surge of prices was greeted by cheers on the Exchange floor. The rally in prices was largely due to tremendous odd-lot purchases. Evidence of the still tremendous wealth of our investing public was clearly shown by the innumerable orders to purchase shares which now poured in upon the market. Gratifying as this exhibition of public investing power was to everyone, it imposed additional burdens on the machinery of the Stock Exchange. It involves practically as much work to execute an order for ten shares as for a thousand, and when the whole public took to buying at once, further congestion in the market was once more occasioned. The lobby of the board room was turned over to the sorting of odd-lot orders, and other steps were taken to facilitate the work. Yet the burden fell not alone on the Exchange floor facilities, but also on members' offices, the stock transfer offices, and in fact throughout the financial district."

## CHAPTER X

### The Bond Market

(Xa) The delayed delivery of bonds is provided for in the Constitution and Rules, Chapter I, B. In respect to interest payable upon contracts in interest paying bonds "regular way delayed delivery" [Rules, Chapter VI, Sec. 3(B)] it is provided that "interest at the rate specified in the bond shall be computed up to but not including

the next 'delivery day' following the date of the transaction and shall be 'flat' thereafter unless otherwise agreed."

(Xb) The more rapid growth on the New York Stock Exchange of its share as compared with its bond business during recent years, is revealed by the following statistics:

## TOTAL LISTING ON THE EXCHANGE

| BONDS                |        |                                      |                                         | STOCKS |                                         |                                         |
|----------------------|--------|--------------------------------------|-----------------------------------------|--------|-----------------------------------------|-----------------------------------------|
|                      |        | Par<br>Value<br>(000,000<br>omitted) | Market<br>Value<br>(000,000<br>omitted) |        | Total<br>Shares<br>(000,000<br>omitted) | Market<br>Value<br>(000,000<br>omitted) |
|                      | Issues |                                      |                                         | Issues |                                         |                                         |
| January 1, 1925..... | 1,333  | \$35,445                             | \$33,599                                | 926    | 433                                     | \$27,069                                |
| January 1, 1926..... | 1,367  | 36,995                               | 35,509                                  | 1,043  | 491                                     | 34,489                                  |
| January 1, 1927..... | 1,420  | 37,900                               | 37,167                                  | 1,081  | 585                                     | 38,376                                  |
| January 1, 1928..... | 1,491  | 36,881                               | 36,874                                  | 1,097  | 654                                     | 49,736                                  |
| January 1, 1929..... | 1,534  | 48,588                               | 47,379                                  | 1,177  | 757                                     | 67,472                                  |
| January 1, 1930..... | 1,543  | 49,058                               | 46,892                                  | 1,293  | 1,127                                   | 64,707                                  |

## REPORTED SALES ON THE EXCHANGE

|           | Bonds           | Shares        |
|-----------|-----------------|---------------|
| 1925..... | \$3,398,346,045 | 452,211,399   |
| 1926..... | 3,029,684,699   | 449,103,253   |
| 1927..... | 3,321,527,600   | 576,990,875   |
| 1928..... | 2,939,627,750   | 920,550,032   |
| 1929..... | 3,020,316,700   | 1,124,990,980 |

## CHAPTER XI

## The Security Collateral Loan Market

(XIa) In such leading European financial centers as London, Paris, Berlin, Amsterdam and Vienna, the security loan markets are less effectively organized than in New York. This is shown by the personal character of such loans abroad, as compared with their almost complete impersonality here. Abroad, in fact, there is little collateral diversification, little or no power of substitution, no units for the loans, and no public or open market for contracting them. Such loans are, in fact, treated merely as advances against securities. A borrowing stock broker or security dealer is accorded what amounts to a "line of credit" with a maximum limit; he utilizes this credit by simply sending to the lender whatever securities he has handy. Usually security margins over the loan amounts are required, but the lender abroad is so poorly protected as compared with New York lenders that he is usually very conservative concerning the character of collateral—a factor which of course makes new industrial security flotations all the more difficult there. The length of such loans is

usually in accord with the prevailing local term settlement, which except in Berlin is for the fortnight.

Normally, also, the European stock broker or dealer will finance himself from one term settlement to another by what amounts to our New York practice of borrowing and lending shares. This is done without security margins, and is therefore a prevalent source of danger to both borrowers and lenders. To protect the latter, however, such loans (called "contango loans" in England, and *reports* on the Continent) are made in the form of an allied purchase and sale. When a "bull" position, for example, is carried over, the borrower sells the security to the lender for cash and simultaneously buys it back from him for the fortnightly account; similarly, a "bear" position is carried over by the borrower buying the security for cash and selling it again for the next settlement.

(XIb) The Bank of England has long discounted "Lombard loans," as security loans are called in the London and Continental markets. It is true that usually the collateral for such loans has in recent years been short-term Treasury notes, known as "floaters," but no statute restrains the Bank from discounting loans upon other securities, and this has been and is done. Ordinarily the Bank keeps its rediscount rates above market rates to avoid inflation by subsidizing rediscount, and in order to favor commercial over financial loans it keeps the Lombard loan rediscount rate over the rediscount rate for bills.

In the Banque de France, a list is published of the securities acceptable as collateral for loans; in this list are included not only bonds of the French State, and of French colonies, departments and municipalities, but also the shares as well as the bonds of French railways.

In the Reichsbank, the Dawes Plan prohibited the discount of loans on German government securities for fear that it might lead to renewed mark inflation. However, the Reichsbank can discount loans on other securities, particularly perhaps the bonds of agricultural mortgage banks. See also the testimony of Governor Benjamin Strong in the "Stabilization hearings," p. 318.

(XIc) When the United States entered the war in April, 1917, a Liberty Loan Committee of prominent New York bankers was at once organized to facilitate the flotation of the inevitable U. S. Government War Loans. Later, a sub-committee known as the "money committee" was appointed to supervise the New York money market during the critical period of strain caused by the Liberty Bond flotations. As stated in a subsequent report by the Federal Reserve Agent

in New York, made to the President of the U. S. Senate at the request of the Governor of the Federal Reserve Board (known as "Senate Document 262, 66th Congress, 2nd session") :

"Prior to the armistice, agencies of the Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment market might not prejudice the success of the Government issues. In these circumstances, with full understanding on the part of the Treasury Department, the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes, in consideration of which the principal banks of New York City endeavored to provide a stable amount of money for the requirements of the security market."

The arrangement above referred to was established after correspondence between Governor Benjamin Strong of the New York Reserve Bank and Chairman of the "money committee," and President H. G. S. Noble of the New York Stock Exchange. The Exchange's Business Conduct Committee required the submission to it daily of the total borrowings on securities of the Exchange members, and saw to it that these were not increased. As Governor Strong subsequently stated ("Agricultural Inquiry," p. 678), ". . . in point of fact, during the period of control, which was exercised by the Business Conduct Committee of the Exchange, I do not recall that the loan account, as reported by the members of the Exchange, increased at all. They held it down by direct contact with the members." At the request of the U. S. Treasury, the "money committee" continued to function into 1919. However, public protests against this artificial control of the money market after the Armistice became so general, that on January 24, 1919, the "money committee," after consultation with the U. S. Treasury, decided (*ibid.*, p. 680) :

"1. That control by the Stock Exchange Committee may for the present be suspended.

"2. That the Stock Exchange authorities be requested to continue to receive from members of the Exchange daily reports of their borrowings until after the next Liberty Loan is placed.

"3. That the definite arrangements made with a large group of New York banks to furnish funds for Stock Exchange loans, if and as required, should now be terminated.

"The money committee desires to acknowledge and record its appreciation of the hearty cooperation which the members of the Stock Exchange and the New York banks have given it during the past months, and feels confident that should it hereafter become necessary, in the interest of Government financing, to reestablish the control of money for Stock Exchange loans and for the stabilization of money rates, the Stock Exchange authorities and the New York banks will again unite, with a patriotic purpose, to lend full support to the Treasury Department."

It was not found necessary subsequently to reestablish the artificial war-control of the money market. At the end of 1922 the Stock Exchange discontinued the system of requiring reports from its members as to their security collateral borrowings, and did not resume it until February, 1926.

The curious student of the 1917-21 period in the call loan market is referred to the aforesaid "Senate Document 262, 66th Congress, 2nd session" and also to the Agricultural Inquiry Report, especially pages 543-546, and 665-684. Developments in the call loan market during and after 1926 may be found *passim* in the "Stabilization hearings," and also in the hearings on the LaFollette resolution.

(XId) The evolution and methods of the present money desk system were excellently set forth in an address by Mr. Robert R. Atterbury, member of the Executive Committee of the Stock Clearing Corporation (October 25, 1928):

"When I first came into the Street—and that was a good many years ago—it was the custom for houses to send clerks out among lending institutions to borrow funds necessary for the day's requirements. There was no fixed rate, and each loan, with each institution, was a matter of personal negotiation, and the rate often varied widely. Later we had what was called an "open money market" on the floor of the Stock Exchange, without supervision, and subject to the violent changes in money rates whenever an unusual demand for or supply of money existed. Competitive bidding and offering—oftentimes entirely unwarranted—made for wide fluctuations of rates, even within the five-hour business day.

"This situation was so exaggerated during the Great War that a money committee of five members of the Governing Committee of the Stock Exchange was formed to cooperate with the banks in controlling, not only the rate, but the disposition of funds available for Stock Exchange purposes. This was at the time of the closed money market, during which the committee of five, together with a committee



of the banks, were the sole arbiters of all matters pertaining to the loaning and borrowing of money.

"During this period the great advantages manifested under such control naturally led to various suggestions looking to some form of supervision, less stringent than that exercised by the committee of five, when normal conditions again prevailed, and the need for this committee was ended. As the outcome of numerous conferences and suggestions, the present money desk was made a fixture, with Mr. Blake in direct charge, but under the supervision and authority of a committee of three members of the Executive Committee of the Stock Clearing Corporation, with Mr. S. F. Streit, President, as Chairman.

"This Committee is responsible for the renewal rate each day, and for any rate changes that may take place from the renewal rate during the day. Money may be placed by lenders at the money desk at the market, or at fixed rates, or borrowers may apply for new loans at the market, or restrict their applications to a fixed rate. In each case, they use their own judgment as to the probable trend of money rates during the day, so you can readily see we have a true open money market, even if under some supervision.

"Now the great advantages of this supervision become evident when one compares the old methods with the present method. In the old days, some houses could obtain whatever accommodation was needed, while others, belated in learning their requirements, or not having so good a credit, had difficulty in obtaining loans, even at exorbitant rates of interest, and there were days when even 100% was bid for money.

" . . . Due to the stability of the rates for money, commission houses find less competition for their cost of money, month by month, and they are able to obtain accommodations without effort or competitive bidding, and the rate for renewal loans is no longer subject to individual negotiation.

"Perhaps a few words in explanation of how the renewal rate is arrived at will not be amiss. The average rate of all loans during the preceding day, the amount of money carried over—that is, unloaned at the end of the day—the amount of money on hand before the renewal rate is made in the morning, and any unusual or extraordinary payments that may be falling due by the banks, which might affect the money market, are all factors entering into the decision as to the money rate. All loans carried over, that is, renewed, are done at the renewal rate of the day, but it is at the pleasure of the borrower or of the lender to return or call any loans if dissatisfied with the rate.

"When you stop to realize that every Stock Exchange house has not one or two but many such loans, and every lending institution hundreds of such loans, you can readily see the great advantages of an agreed-upon rate covering all renewals, and so obviating the hundreds of telephone calls, misunderstandings, and confusion which would necessarily arise if each loan, or even each house or institution, had to make individual arrangements as to the renewal rate.

"Now when a brokerage house requires money, the ordinary way is to send a slip to the money desk, asking to borrow, say, \$100,000, or whatever the amount may be. These slips are honored in the order of their receipt, and what money there is available at the time is apportioned to borrowers, by the clerk at the money desk, in their regular order, and as far as the money available will permit. In the same way, money is placed at the money desk by the lending institutions, either directly or through their Stock Exchange representatives, and is distributed among the borrowers under exactly similar conditions.

"The customary procedure is something like this: The cashier of a house sends word to the floor telephone clerk to borrow, say, \$100,000. The telephone clerk writes, probably on an order pad of his firm, 'Borrow \$100,000,' and sends the slip to the money desk. The clerk at the desk files these slips in the order in which they are received, and, as promptly as possible, writes on the slip the name of the lending institution and the rate at which the loan is made. This slip is then sent back to the telephone clerk of the borrowing house, and at the same time the clerk at the money desk notifies the bank of the loan just made, and the rate, giving both the name of the house and the rate, so, you see, the borrower and the lender do not come together. The details are all arranged through the clerk at the money desk. It is as simple as it can possibly be made.

"Of course there are times when the borrowing demands cannot be satisfied with the funds on hand, and then it becomes necessary to attract money by the effectual method of raising the rate. The opposite side of the picture occurs when there is a lack of borrowing with plenty of money on hand, and the law of supply and demand is again the controlling influence effecting the temporary changes in the rate which you so often see.

"In this connection I might say that the efforts of the Money Committee in charge of the money market are all centered in keeping a stable money market, and preventing, as far as possible, not only wide fluctuations in the rate, but even the change in the rate whenever

it is at all possible, and in their efforts to do so they have had the cooperation of most of the large lending institutions."

Governor Benjamin Strong bore witness to the rapid improvement in the Stock Exchange technique of handling security loans, in the Stabilization hearings, p. 354. In the hearings on the amended stabilization bill (p. 192), Dr. Adolph Miller stated: "The greatest open money market in the country today is the call loan market. It is more important than it ever was, and vastly more important than anyone ever thought it could become after the enactment of the Federal Reserve Act. It is the most available market, the most attractive market, that exists for idle funds. Anybody from the Atlantic to the Pacific, from Canada to Mexico, who puts his money into the money market today, provided the loans are properly handled, knows that he can always get his money out whenever he wants it."

(XIe) Senate Document 262, 66th Congress, 2nd Session (p. 6), states: "In the matter of the supply or attraction of funds to the call-money market, there is generally a definite and well-understood obligation on the part of the banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call-money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been recognized that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded."

The same authoritative document goes on to say: "It is the universal custom of the banks to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides, as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market

is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans."

In the Stabilization hearings (p. 368) Governor Benjamin Strong stated: "Here we have a large group of country banks which, for one or another reason, have funds that they cannot use locally or are unwilling to use locally. What are they going to do with them? They will not lock them up in cash in their vaults. They send them somewhere for employment, in order to earn money on them. Also, when they are not members of the Federal Reserve system especially, they require balances in money centers in order to meet the requirements of their customers who make payments there, and the amount of that fund in the money center—in the central exchange market—fluctuates according to changes in rates reflecting changes in demand and supply, and according to the local needs of the bank. I do not see how it is going to be possible, by some mandate of law, to regulate that. In a way, it regulates itself. It is an inherent characteristic of our type of banking in this country."

Dr. Adolph Miller (hearings on amended Stabilization bill, p. 120) stated: "It may be that there is such a considerable spread between the call rate in New York and the Federal Reserve discount rate, say, at an interior Reserve bank, as to put a temptation before the interior bank, if it has any money loaned on call in New York, to leave it there and meet the demands of its local customers by rediscounting with its Reserve bank. Such has undoubtedly been the case at times."

On the other hand, the testimony of Dr. Walter Stewart (Stabilization hearings, p. 765) stated: "The demand for credit for commercial purposes will always have first call on banking credits . . . For one reason, it involves the relation between the bank and the line-of-credit customers, and secondly, the loan usually yields a better rate of return than the call loan . . . I think any well-managed bank, in addition to the loans to customers, would undertake to have some money in liquid loans—call loans, etc. I think in the last four or five years the growth of brokers' loans has not been at the expense of credit available for commercial purposes . . . I think the use of credit in the securities market, in view of the general organization of credit and banking, is a legitimate use."

"In considering bank credit it is seldom realized that of the \$30,000,000,000 in member bank loans and investments, about half represents either loans on securities or investments direct. We are in the habit of thinking of our banks as a commercial bank system, but they have either loans on investments or investments to the extent of about half of their total resources."



In the hearings on the La Follette Resolution, this same question frequently arose. The text of the resolution blithely assumed that agriculture was being deprived of credit by the call loan market. But Professor O. W. M. Sprague in his testimony (p. 32) stated that most banks are local banks, and their local business is most profitable. "The rates on their local business are in general higher than upon brokers' loans. Banks are not tempted to invest in brokers' loans primarily by the rate of return, since this rate is regularly lower than the rate on local loans. They invest in brokers' loans primarily because they do not find in the local situation a volume of satisfactory loans sufficient to absorb all of their funds consistent with safety." And again (p. 33): "A well-conducted bank holds in part customers' loans. These loans ordinarily cannot be liquidated in any large measure without loss of standing of the bank as a going concern . . . if the bank is to utilize its resources at all times, it must ordinarily invest a part of its resources outside, in an impersonal way . . . holding a quasi-reserve, and that is one of the reasons for the shifting of funds to the large money centers from the small money centers . . . Now the query presents itself whether they are draining money which might be properly and desirably utilized in their own locality or whether they are sending money there because they do not find a reasonably safe and reasonably liquid use for those funds in their own locality. Now, I will say that, by and large, beyond the point of a quasi-reserve, there would be a moderate amount of money transferred to New York, either to be carried as a balance or to be lent on call, the balance, the increasing amount, represents funds which the banks, in their best judgment, do not find it feasible and safe under existing conditions to employ in their own localities." Again (p. 37), Professor Sprague reiterates: "It is not at all certain that you can employ all the funds of a bank locally; that it may not be to the advantage of the community, and may be unsafe for the bank; and that on the whole, the inducement is very strong on the part of the bank to employ all of its funds locally that it considers to be safe . . . A great many of our 26,000 banks clearly have employed more funds locally than was in fact safe. They misjudged the situation. Whether there are some bankers who are unduly pessimistic about their localities, lacking in enterprise, and who fail to put an adequate amount or a reasonable amount into the local situation, is probably true, but I think such cases are exceptional."

Governor Roy Young of the Federal Reserve Board, testifying in the same hearings (p. 69) stated: "The second inquiry that I made of myself was this: is this volume of credit that is going into the



stock market denying commerce and industry credit? I can find no evidence of credit being denied to commerce or productive industry." Again (p. 76): "I cannot discover anywhere where commerce and industry have been denied credit for the benefit of making these brokers' loans."

(XI<sup>f</sup>) The true economic nature and significance of call loan rates were well set forth in the analysis of the call loan market made in "Senate Document 262, 66th Congress, 2nd Session" (p. 9): "The underlying cause of fluctuations and especially of increases in call money rates is the operation of the law of supply and demand. In other words, as the supply of loanable funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of daily borrowings of call money—to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans—other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates are mainly due to other demands for credit, resulting in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation."

(XI<sup>g</sup>) "The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not usurious under the laws of the State of New York, which specifically exempt collateral call loans from the 6 per cent limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the banking law (L. 1914, ch. 369; Consol L., ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments, as collateral, any bank may receive and

collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

SECTION 115. Interest on Collateral Demand Loans of not Less Than Five Thousand Dollars. Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction.

"Section 201 of the banking law, identical in language with section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the general business law (L. 1919, ch. 25; Consol L., ch. 20) there is the following general provision of a like character:

SEC. 379. Interest Permitted on Advances on Collateral Security. In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction.

"The national-bank act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

422, SEC. 3197. Limitation Upon Rate of Interest Which May Be Taken. Any association may take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more except that where by the laws of any State a different rate is limited for banks of issue, organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the day for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

"It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral loans of not less than \$5,000 rates of interest which may be in excess of those permitted

for loans of other character, and that such higher rates are not prohibited as usurious . . .” (Rates of Interest on Collateral Call Loans, Sen. Doc. 262, 66th Congress, 2nd Session, pp. 4-6).

In 1929 steps were taken in Illinois to exempt call loans in Chicago from the State usury law, in order to develop a Chicago call loan market on securities like that of New York. A similar development occurred in Pennsylvania in order to assist placing the Philadelphia call loan market upon a less constrained and artificial basis.

(XIh) In 1890 call loan rates touched 186%; in 1892, 40%; in 1893, 73%; in 1895, 100%; in 1896, 127%; in 1899, 186%; in 1901, 75%; in 1905, 125%; in 1906, 60%; and in 1907, 125%.

Since the establishment of the Federal Reserve system, the highest rate reached by call money was 32% in 1919. It must of course be borne in mind that all such rates are on a per annum basis, that of all outstanding call loans only a very few were actually contracted at those maximum rates, and that presumably borrowers at such rates paid them for one day only, and renewed their loans at a lower rate next day. See also the testimony of Dr. Adolph Miller of the Federal Reserve Board in the Stabilization hearings (p. 681).

In 1929 call loan rates touched 20% and for some months ruled unusually high, as a result of the Federal Reserve Board's attempt to deflate stock market loans. The wisdom or justification of this policy became a subject of active controversy. See the address entitled "Stock Market Loans," by President E. H. H. Simmons, May 9, 1929, in Chicago.

(XIi) The chief rules in the Stock Exchange Constitution dealing with the hypothecation of customers' securities are Chapter XII, sections 2 and 4, reading as follows:

SEC. 2. The improper use of a customer's securities is inconsistent with just and equitable principles of trade.

SEC. 4. An agreement between a member and a customer, authorizing the member to pledge securities, either alone or with other securities carried for the account of the customer, either for the amount due thereon, or for a greater amount, or to lend such securities, does not justify the member in pledging or loaning more of such securities than is fair and reasonable in view of the indebtedness of said customer to said member.

(XIj) The accuracy with which renewal rates are made can readily be determined by comparing them over a period with the average call rates paid at the money desk on new loans. The Annual Report of the President of the New York Stock Exchange for 1929-30 (p. 108) reports these differences between the annual average rate

for renewals and the annual average rate on new loans since 1922 as follows:

| Year       | Difference |
|------------|------------|
| 1922 ..... | .069 of 1% |
| 1923 ..... | .025 " "   |
| 1924 ..... | .005 " "   |
| 1925 ..... | .029 " "   |
| 1926 ..... | .007 " "   |
| 1927 ..... | .008 " "   |
| 1928 ..... | .095 " "   |
| 1929 ..... | .082 " "   |

Also, when either borrowers or lenders, or both, feel that renewal rates do not accurately reflect the fair current price for call money, their tendency is greater to call rather than renew, and to attempt to make new loans later at more favorable rates. In consequence, the volume of turnover at the money desk will increase. Yet it is significant that when this turnover has been proportionately greatest, it has amounted to only a negligible fraction of total outstanding call loans, thus indicating the high degree of recognized accuracy with which renewal rates are made.

(XI<sub>k</sub>) The safety of stock market loans to lenders has frequently been pointed out by leading financial authorities and students. In the La Follette Resolution hearings (February-March, 1928), O. W. M. Sprague, Professor of Banking and Finance in Harvard University stated (p. 31, *et seq.*):

"There are at the present time 26,000 banks in the United States. Five years ago there were nearly 30,000. Between 3,000 and 4,000 have failed in that period of five years. It is, therefore, I think, pertinent to inquire whether banks have failed because of brokers' loans, and also to inquire whether, if obstacles are placed in the way of using funds for brokers' loans, the number of bank failures might be affected, either to increase or decrease them . . .

"These 26,000 banks are in the main local banks. The rates on their local business are in general higher than the rates upon brokers' loans . . . They invest in brokers' loans primarily because they do not find in the local situation a volume of satisfactory loans sufficient to absorb all of their funds, consistent with safety . . . that prevails throughout virtually the entire country . . .

"During 1920 we had a period of inflation during which prices on land and of commodities were rising rapidly, and it was practically impossible during that period of abnormal advance in prices for banks to fail; but those banks which put all of their funds into a local situa-

tion, especially where the local situation was one of a single industry or a single occupation, and whose values of land and values of inventories were inflated, have either failed or experienced exceedingly great difficulties . . .

"The First National Bank of Miami, Florida, held \$66,000,000 of deposits at the height of the boom, and it had \$8,000,000 lent in Miami, and the rest of its funds were in balances in New York banks, in call loans and in United States bonds and other available bonds. When deposits went off from \$66,000,000 to, I think, \$23,000,000 it was able to meet that situation . . . That is sound banking . . . it does not seem to me altogether wise to create by legislation conditions which will confine the employment of bank funds to local uses . . . now, so far as safety goes, I do not think that any serious objection can be raised against the brokers' or dealers' loans. The records in regard to losses of banks, although not perfect, clearly indicate that the losses of banks arising out of this class of loans have been very small."

In the Stabilization hearings (p. 679), Dr. Adolph Miller of the Federal Reserve Board, speaking of loans available to country banks, declared of the call loans on security collateral "it is the safest loan there is."

In an address by Robert R. Atterbury upon "Call Loans and the Renewal Rate" (October 25, 1928), he stated: "The president of one of the largest banks, which is a large lender in the Street, told me only a short time ago, that in forty years connection with the bank and in lending hundreds of millions of dollars during that time, they had only lost a matter of less than \$15,000, and he laughingly added that that was his own fault."

In an address by President E. H. H. Simmons in Omaha in 1928, he stated: "Today the New York call loan market is undoubtedly the most highly organized security loan market in the World. For many years there has never been a loss to a single lender arising from a call loan made to a Stock Exchange member and based on the collateral of Stock Exchange securities. Thus call loans are unparalleled in their safety to lenders, for the same safety has not been seen even with Government bonds."

In the hearings on the La Follette resolution (p. 39), Professor O. W. M. Sprague stated: ". . . as far as safety goes, I do not think that any serious objection can be raised against the brokers' or dealers' loans. The records in regard to losses of banks, though not perfect, clearly indicate that the losses of banks arising out of this class of



loans have been very small. Therefore . . . I rule out the matter of risk."

In the same hearings (p. 40), Senator Carter Glass said: "Before you leave the point of securities and bank failures, I may say for myself that I do not think any loan is ordinarily safer than brokers' loans."

In the same hearings (p. 69), Governor Roy Young testified: "The first question was, are brokers' loans safely and conservatively made? From all the information I can gather, I do not think there can be any question about the safety of these loans at this time, and of their liquidity." Again (p. 77): ". . . I am not prepared to say whether brokers' loans are too high or too low. I do not think anybody else can say so. I am satisfied that they are safely and conservatively made." The Hon. Edmund Platt (*ibid.*, p. 88) referred to brokers' loans as "the safest loans the banks make."

Similar testimony was given by Dr. Adolph Miller in the "Stabilization hearings"; he refers (p. 679) to brokers' loans as "the safest loan there is," and (p. 681) "it is hard to imagine a contingency under which there would be any difficulty in getting their (i.e., the country banks') money back promptly." Dr. Miller also stated (p. 848): "While in the olden days there was no question as to the goodness of these collateral loans—their safety and security—experience has demonstrated, notably in 1907, that at times of acute strain and monetary stringency out-of-town banks might have difficulty in recovering for home use the balances that they had in New York. It was impossible for all to liquidate at the same time successfully and get the cash; and so we had the sharp periods of monetary famine, of which 1907 was perhaps the most acute . . ." Dr. Miller went on to point out that today, owing to the Federal Reserve system, flexibility had been provided in our banking system and thus country banks today can freely withdraw funds which they have invested in the New York call loan market.

In the hearings on the amended Stabilization bill, Professor J. R. Commons stated (p. 436): "The call loan market . . . is the most secure and liquid of all markets."

It should in conclusion be noted that the events of October-November, 1929, thoroughly demonstrated the safety and liquidity of call loans.

(XII) Respecting the economic functions of call loans, Dr. W. R. Burgess in the Stabilization hearings (p. 1007) stated: "While the stock exchange money market represents in a narrow sense speculation, you must remember that on the other hand it represents the

buying of securities which represent a part ownership in our national wealth and our national industry; our great industrial concerns all over the country that are, in part at least, dependent on the ready sale of their securities in the money market."

In the hearings on the La Follette resolution (p. 51), Dr. O. W. M. Sprague stated: "I suppose we shall all agree that a considerable volume of bank credit is properly employed, first, in financing the marketing of new issues of securities, and in the second place, in making a market for outstanding issues. Now a market for outstanding issues is impossible in the absence of a certain amount of speculation," and again (p. 53): ". . . I should hold that bank credit is legitimately employed in connection with dealings in the securities market . . . insofar as such transactions are necessary and desirable in order to create a market for outstanding issues of securities. The point at which it may be said that undesirable speculation is reached is that at which the volume of credit is such that it permits and accentuates dealings on the exchange which give rise to prices of large numbers of securities which are not reasonably justified by the earning power of the company."

(XI<sub>m</sub>) One of the most typical instances of the behavior and function of stock market loans in a business cycle, occurred during 1918-21. The intense though short-lived post-Armistice boom caused stock market loans by Federal Reserve member banks to rise from \$770,293,000 on November 15, 1918, to \$1,518,266,000 on November 7, 1920; at the same time all loans and investments of all reporting Federal Reserve member banks rose from \$13,917,244,000 on November 15, 1918, to \$15,570,591,000 on November 7, 1919.

But on November 7, 1919, stock market loans reached their peak, and thereafter declined, while all loans and investments of Federal Reserve member banks continued to expand. On October 15, 1920, the latter reached their peak at \$17,283,996,000, but by that time stock market loans of Reserve members had declined to \$973,074,000. Thus, over the period of November 7, 1919, to October 15, 1920—the critical period financially—\$545,192,000 had been deflated from stock market loans and reloaned to merchants, farmers and manufacturers, along with \$1,168,213,000 additional—accounting for the rise of \$1,713,405,000 in Reserve members' total loans and investments during this period. Thus the stock broker and his customers began to be deflated almost a year before the general contraction in banking credit began. That the agricultural districts of the country obtained additional funds in this way and at this time was conclusively established by the testimony of former Governor Benjamin Strong of the Federal Re-

serve Bank of New York, before the Agricultural Inquiry Commission in Washington in 1921 (p. 650).

That the proportional deflation of stock market loans was not only earlier but also more severe than that attending other uses of bank credit is also revealed clearly by the relevant statistics. Stock market loans declined from a peak of \$1,518,266,000 to a "bottom" of \$680,448,000 on September 7, 1921—a total decline of \$837,818,000, or 55%. But the decline of all Reserve member loans and investments from their peak of \$17,283,996,000 to their "bottom" of \$14,726,585,000 amounted to \$2,557,411,000 or less than 15%.

## CHAPTER XII

### Comparison and Security Clearance

(XIIa) In his thesis "The Evolution of Financial Clearance in New York," Mr. Herman H. Cohen did a valuable piece of research into the origins of security clearance and settlement methods in New York, whose more important facts are briefly summarized here.

Almost since 1853, when the New York Bank Clearing House was established, a simple system for clearing security contracts made on the New York Stock Exchange found its hearty advocates, especially after the panic of 1857. The success of the contemporary experiment in security clearance by the Frankfort Handelskammer was observed with interest. For the time being, however, nothing constructive was accomplished.

After the Civil War, activity in the stock market again created interest in the subject of security clearance, particularly since the clearing system on the Gold Exchange had recently achieved an undoubted success. Accordingly in 1868 a company with an authorized capital of \$1,000,000 was organized by Stock Exchange members to perform a security clearance business on a fee basis. But the use of this organization was not made compulsory, either by the Stock Exchange or the Open Board of Brokers, and although moderately efficient, it soon failed to develop sufficient clientele to survive. In 1873 a second attempt was made, based largely upon the European term settlement systems. Although the New Stock Exchange sufficiently amended its constitution to permit of dealings "for the account," members of the Exchange almost invariably preferred to trade "regular way" for settlement the next day. As a result, in a very short time this second attempt failed.

After the failure of 1873, half-hearted and equally futile attempts to inaugurate security clearance occurred in 1877, 1879, and 1880,

but no serious effort was made until July, 1882. By this time, New York banks had become alarmed at the large totals to which certification of checks to stock-brokers required by current stock market activity had reached. Accordingly, some system for obviating unnecessary certification became more and more desirable. A new system planned by a Mr. Osterburg was sponsored by several large brokerage houses and embodied in the "New York Stock Clearing House Association"—an organization entirely independent of the Stock Exchange, capitalized at \$200,000, and to be supported by fees paid by its users. Nevertheless only 85 out of the 1,100 Stock Exchange members could be persuaded to employ the new service, and the effort to maintain it was speedily abandoned.

The next attempt was made by the Stock Exchange itself, and the "Auditing Department of the New York Stock Exchange" was established in 1885 at 14 Broad Street for the weekly settlement of Exchange contracts; its employment remained voluntary, however, and was so little resorted to that the effort soon failed.

Meanwhile the volume of Stock Exchange sales continued to grow, to cause congestion in member offices, and to put an undue strain on the New York money market. During the whole period of these unsuccessful attempts to establish a security clearing system in New York, certain Stock Exchange brokerage firms had become accustomed in a limited way to clear contracts for fellow-members on payment of a clearance fee. This practice dates back before 1880, was continuously followed till 1892, and is indeed still in vogue to some extent. The usual charge before 1892 for such service was \$1 for each 100 shares both received and delivered, but if stock was carried overnight the charge was \$3.12 (or "three and a shilling" as it was called) accompanied by adequate margin. Only minor economies were effected by this practice. In 1888 an attempt was made to "centralize" this clearing practice by appointing the Manhattan Trust Company as a clearing house under control of a Stock Exchange committee; again this plan was made voluntary for Exchange members, and again insufficient interest was aroused to lead to success.

Thus, for over 30 years every attempt to inaugurate a security clearing system had ended in failure, owing primarily to the disinclination of Stock Exchange members to expose the facts and figures of their business to the scrutiny of others, and perhaps the additional clerical work entailed. For these reasons, the use of the various clearing systems was never made compulsory by the Exchange for its members, and voluntary systems failed to attract sufficient support to achieve success.



Meanwhile, however, the continual growth of stock market activity rendered the problem of certification increasingly burdensome to the banks. Stockbrokers themselves likewise experienced greater and greater difficulties in making security deliveries and money payments each day under the cash settlement system. It was thus the growth of the stock market itself which primarily brought matters to a head. A Special Committee appointed by the Stock Exchange to study the subject reported. "Our present system of actual payment of entire value in every transaction blocks up in active times both banks and offices to an intolerable extent, and is an obstacle to the growth of the business commensurate with the growth of the country."

The clearing system proposed by the Committee and later adopted by the Exchange (today embodied in the work of the Night Clearing Branch) was not original but modeled upon previous attempts in New York and upon stock clearing systems successfully inaugurated in other American cities. It differed fundamentally from European clearance systems, since it was based upon a daily rather than upon a term settlement. Its most significant features consisted in the thoroughness and accuracy of its detailed provisions, and in the fact that it was made compulsory for its members by the Stock Exchange. The conservative fears of many Stock Exchange members led 244 out of 1,100 members to vote against the constitutional amendment by which the Exchange adopted this compulsory clearing system. The first clearance was held May 17, 1892—the centennial of the first New York stock-brokers' agreement from which the Exchange originally derived. The result was awaited with curiosity. Only four stocks were cleared—Reading, St. Paul, Louisville & Nashville, and Northern Pacific preferred. Only one error was reported, and the guilty member was fined \$5. On this day shares cleared both sides were 261,000, valued at about \$16,000,000. Stock balances amounted to only 25,000 shares worth \$1,383,000, and cash balances amounted to \$822,000. Thus, even in the clearance of only four active stocks, the new system obviated the employment of approximately \$7,000,000 in certified checks; the manager of the clearing house and his ten clerks could consequently look with real satisfaction on this first day's work.

The emphatic success of the new system almost immediately dissipated the objections which some Stock Exchange members at first entertained in regard to it, and its obviation of the need for large amounts of certified checks won for it the instant approval of the banks. Exchange members found that special clerical work required by it was more than offset by the economies which it effected for them, and experience showed that fears as to possible dangers of the revealing



of their accounts to others were in practice unfounded. The signal services of the stock clearance during the panic of 1893 and the boom of 1901 clinched the arguments in favor of the practice.

The legal aspect of the new stock clearing system had yet to be clearly established, since few if any direct precedents for such a practice existed—at least in New York State. Objections to security clearance on legal grounds were always based upon misconceptions, however, and have gradually died out as the principles of clearance have become more familiar in other lines of financial and commercial business.

The evolution of the Stock Clearing Corporation has been described *passim* in the text, but its outstanding stages can be briefly chronicled here. On April 26, 1920, the Corporation inaugurated its Day Branch operations, which at first were confined to a money clearance and settlement of the cash extensions of its members' Night Branch share balances, and after March 22, 1921, of Liberty Bond balances. Gradually, however, the Day Branch began to perform a similar money clearance and settlement with securities not cleared in the Night Branch—on September 15, 1922, with non-cleared shares, on December 8, 1922, with non-cleared foreign bonds, and on June 5, 1923, with all other non-cleared bonds. By this last date, all securities traded in upon the Stock Exchange were cleared and settled as to their money amounts by the Day Branch, except for lots of less than 100 shares or \$1,000 par value of bonds.

The clearance of members' security collateral loans was inaugurated by the Day Branch on March 22, 1921. Also, almost from its inception the Day Branch has conducted special clearances, especially in "when issued" securities. The Transfer department was established May 31, 1923, to handle the assignable transfer receipts; on September 20, 1926, the similar employment of exchange receipts began, and shortly afterwards the use of the temporary exchange receipts. Settlement of commission bills through the Stock Clearing Corporation was inaugurated July 16, 1927. The Central Delivery Department first opened for operation on April 18, 1929.

During the post-war period, clearances in active bonds had been held—particularly in U. S. Liberty Loans and foreign government bonds. This was discontinued when these issues became inactive in the market. But on November 26, 1929, clearances of active bonds—particularly convertible issues—were resumed. On June 3, 1930, machine clearance for cleared bond contracts was inaugurated.

(XIIb) The following excerpts, taken from Chapter II of the Constitution and Rules, relate to comparisons:

SEC. 1. It shall be the duty of every member to report each of his transactions as promptly as possibly at his office, where he shall furnish opportunity for prompt exchange of tickets or comparison.

SEC. 2. An exchange of tickets shall be made in the manner required by the By-Laws and Rules of the Stock Clearing Corporation and shall constitute a comparison. In all cases in which an exchange of tickets or special contract exchange tickets is not so required, comparisons shall be made by an exchange of an original and a duplicate comparison ticket; the party to whom the comparison ticket is presented shall retain the original, if it be correct, and immediately return the duplicate duly signed.

SEC. 3. It shall be the duty of the SELLER to exchange tickets or to make comparison in respect to each transaction at the office of the BUYER.....

SEC. 7. The neglect or failure of a member to exchange tickets on a contract in cleared securities as defined in the By-Laws and Rules of the Stock Clearing Corporation, which contract is to be cleared through said Corporation, shall constitute a default;.....

SEC. 9. No exchange of tickets or comparison or failure to exchange tickets or to compare, and no notification or acceptance of notification, such as notification of failure to receive or failure to deliver, shall have the effect of creating or of canceling a contract, or of changing the terms thereof, or of releasing the original parties from liability;.....

SEC. 10. The price at which an order is executed on the Exchange shall be binding, notwithstanding the fact that an erroneous report in respect thereto may have been rendered; and no member shall assume or pay any part of the difference between the price at which an order is executed and the price at which it may have been erroneously reported.

(XIIc) The severest test of the Night Branch machinery in recent years arose during the 1929 panic. Since the Night Branch security clearance is necessarily the first step in the whole process of clearance and settlement under the Stock Clearing Corporation, any delay here tends to delay all subsequent parts of the work. At times during the 1929 panic the Night Branch clerks could not obtain the sheets and tickets necessary for clearance from the members until late into the night, and accordingly they were compelled to sleep in the Night Branch offices and for the first time in many years do their work in the day time. In his address, "The Work of the New York Stock Exchange during the Panic of 1929," (Boston, June 10, 1930) President Richard Whitney stated:

"A further difficulty arose in connection with the operation of the Stock Clearing Corporation, through which contracts made on the floor are regularly cleared and settled. When the Clearing Corporation was originally organized in 1920, the terrible lessons of 1907 were kept clearly in mind, and the institution was designed to operate safely in critical stock market periods. This wise foresight yielded invaluable results in the supreme test which occurred last autumn. Indeed,

as far as the Clearing Corporation was concerned, it showed itself extraordinarily able to handle the huge volume of business imposed upon it. But the confusion on the floor of the Exchange in regard to the identity of other parties to many contracts, prevented Exchange firms from making out promptly and accurately the ordinary documents necessary for the Clearing Corporation to perform its work. A stock clearing house, of course, resembles a bank clearing house in that all its items must balance. When many Exchange firms could not for the time being state with what other firms they had dealt, there was danger that the Clearing Corporation could not perform its ordinary and most necessary work.

The Clearing Corporation, in addition to stimulating houses whose delays were holding up the whole community, itself stepped into the breach by creating a special account upon which, as it happened, my own name was by agreement placed. Through this account were put the various contracts on which the second name was lacking. Still later the Clearing Corporation directly accepted delivery of stock on all such contracts itself, thus vastly relieving this problem. At the peak load, the Clearing Corporation took in from the member firms many thousand shares of stock, and paid out thereupon several millions of dollars. It is very creditable both to the Clearing Corporation and to the Exchange firms that this whole tangle was ultimately unraveled without any loss therefrom to the Stock Clearing Corporation. The Clearing Corporation also performed a valuable service to the financial community in undertaking even in the midst of the panic a clearance of bonds, for at this time stock market fluctuations had rendered certain convertible bond issues—particularly that of the A. T. & T.—very active and contracts in them were becoming seriously congested."

## CHAPTER XIII

### Security Delivery and Transfer

(XIIIa) The office-to-office delivery of securities between New York Stock Exchange members was the custom of the New York stock market from its earliest days until very recently. The long adherence to this wasteful and uneconomic system of decentralized security deliveries may be attributed in part to the less deliverable character of American registered shares, as compared with French or German bearer shares, and also perhaps to the contagious direct delivery practice of the London Stock Exchange. In 1913-14 Mr. S. F. Streit then a Governor of the New York Stock Exchange and later President

of the Stock Clearing Corporation, went abroad to make a survey of security handling and settlement practices in London, Paris, Berlin, and Vienna, which, among other things, made apparent to many Stock Exchange Governors here the theoretical benefits of centralizing security deliveries. The war period for some years interrupted the development of this idea. On September 10, 1924, a special committee upon Security Centralization was appointed, to investigate broadly the possibilities of improving New York security handling practice. Careful surveys were made of the transfer and registration of shares, their delivery, "substitutions" in loans, and many other such phases of the problem. In 1926 the Economist to the New York Stock Exchange went abroad to make a thorough survey of security handling and settlement practices under the London Stock Exchange, the Berliner Borse, and the Paris Parquet and Coullisse.

In London as in New York, security deliveries are made direct between offices, although the Share and Loan Department of the London Stock Exchange maintains facilities for the handling of contracts in securities which are temporarily tied up in the process of transfer. In the *Giro-Verkehr* (or "Turnover Department") of the Bank des Berliner Kassen-Vereins, facilities are established for the centralization of security deliveries between members of the Berlin Stock Exchange; the Kassen-Verein, however, takes no responsibility for the goodness of such deliveries, and simply serves as a "post-office" system to economize the employment of time and messengers in making Stock Exchange security deliveries. The Compagnie des Agents de Change in Paris has established the best centralized security delivery that the writer has ever studied, since here the central authority passes upon and accepts responsibility for the legitimacy and deliverable character of the security certificates passing through it. But in making this comparison between French and German methods, it is only fair to point out that the Berlin term clearing organization—the *Liquidationskasse A. G.*—assumes full liability on all Borse members' cleared term security balances, and that the check and deposit department (*Giro-Effekten-Depot*) of the Kassen-Vereins has strict rules and thorough surveillance over security certificates accepted by it for deposit.

The main reasons why the centralization of security deliveries has been developed in Paris and Berlin but not in London and New York are: (1) the predominant use of bearer shares and bonds in France and Germany has made such an evolution obvious and easy there, while the prevailing use of registered bonds and shares in London, and of registered shares in New York, has inhibited any such spontaneous



development of this sort; and (2) both London and New York have specialized and concentrated financial districts in which a decentralized security handling system would "work" tolerably well, while it could not prove equally satisfactory in Paris or Berlin, where financial houses are to a greater extent scattered throughout the city.

The Security Centralization Committee of the New York Stock Exchange, although conscious of the theoretical (and perhaps in New York the ultimately practical) value of handling securities by the check-and-deposit system of the Bank des Berliner Kassen-Vereins, decided that before this superior practice could be effectually inaugurated in New York, it would first be necessary to centralize the security delivery system under the New York Stock Exchange. Accordingly, in 1928 the Exchange authorized the establishment of a Central Security Delivery Department, and the Stock Clearing Corporation undertook to work out the details of its operation. A room in the basement of the Stock Exchange building near the corner of Wall and Broad Streets was accordingly remodeled, provided with windows and cages for receiving and delivering security tellers, and tables and racks inside for sorting out and temporarily filing the securities to be delivered through the Department. The new delivery system was actually inaugurated April 18, 1929; at first deliveries of only a few large and active share issues were handled through it, with the idea of testing the new system practically before extending its scope widely to the security list. The economies and greater speed of settlement obtained by the new system quickly led to its increased employment with listed issues.

(XIIIb) Since, by rule of the New York Stock Exchange (Constitution, Article XXI) corporations cannot possess or exercise membership in the Exchange, the incorporated New York banks and trust companies cannot be members of the Stock Clearing Corporation on the same basis as Stock Exchange members. Nevertheless, a considerable volume of security deliveries and payments is made daily between the incorporated New York banking institutions and members of the New York Stock Exchange, in respect to which the Stock Clearing Corporation can effect the same savings as in the dealings between Exchange members.

As a preliminary and experimental step in developing centralized delivery, the Stock Clearing Corporation during January, 1928, established facilities for centralizing security deliveries, and clearing and settling money payments therefor, in dealings between all Stock Exchange members and two large New York trust companies. This service was of course on a voluntary basis, and was at first utilized



more for bank deliveries to Stock Exchange firms than for deliveries from the latter to the former. Subsequently in 1929 and under a revised and improved system, additional leading banks entered into agreements with the Stock Clearing Corporation to employ the service.

The Stock Clearing Corporation first obtains notification from the banks that they will deliver through it, and contingent lists of the items to be delivered are put at its disposal. Comparison on all items to be delivered is effected by the passage of a "three-way" ticket from Exchange firms to the banks, who keep one part of the ticket and return the other two to the Stock Clearing Corporation. The Central Delivery Department then acts as intermediary between the banks and the cages of the Day Branch; in behalf of Stock Exchange firms it receives security deliveries from the banks, in each case turns those securities over to the cage where the receiving Stock Exchange member's account is kept, obtains at the same time from the cage sufficient funds from the member's accommodation there to pay for the securities, and pays the bank for the security deliveries with its own checks. Stock Exchange member accounts in the Day Branch cages are debited by means of deliver tickets made out by the Central Delivery Department on behalf of the banks.

When a Stock Exchange firm delivers securities to a bank through the Central Delivery Department, after a contingent list is furnished to the Stock Clearing Corporation and comparison on its items effected, the Exchange firm delivers the securities to the Central Delivery Department and obtains credit for their money amount at its cage in the Day Branch. When the bank calls at the Central Delivery Department, the securities are turned over to it against its payment for them by its own check.

The purpose of this bank-Stock Exchange centralized security delivery system, with its accompanying money clearance and settlement, is to effect economies in time, labor and credit, and to afford to both deliverers and receivers superior protection and safeguards. To anyone familiar with the source and extent of such economies in other phases of the work of the Stock Clearing Corporation, as set forth in preceding pages of the present study, the usefulness of these particular operations should be obvious. It has been the practical demonstration of these benefits which has subsequently led the leading New York banking institutions to avail themselves of the facilities thus placed at their disposal by the Stock Clearing Corporation. Recently, the facilities of the Central Delivery Department have been similarly extended to non-Stock Exchange member banking institutions of New York for handling security deliveries between themselves.

(XIIIc) The face of the Stock Clearing Corporation transfer receipt reads:

Stock Clearing Corporation hereby certifies that it has received certificate(s) No.(s).....for.....shares of the..... stock of....., with assignment(s) thereof to....., hereinafter called the transferee, and irrevocable power(s) of attorney, duly executed by the transferee, authorizing the transfer of said stock. Said certificate(s) of stock is/are to be presented by the Stock Clearing Corporation for transfer to the transferee upon the books of the corporation issuing the shares, and upon the receipt by the Stock Clearing Corporation of the new certificate(s) and the presentation and surrender to it of this receipt, Stock Clearing Corporation will deliver said new certificate(s) and said assignment(s) and power(s) of attorney executed by said transferee to the transferee or, if this receipt has been properly endorsed, then to the person specified in said endorsement or to the holder hereof if the endorsement is in blank. Title to this receipt is transferable with the same effect as in the case of a negotiable instrument. Dated..... Stock Clearing Corporation by....., Assistant Manager.

(XIIId) The face of the Stock Clearing Corporation exchange receipt reads:

Stock Clearing Corporation hereby certifies that it has received securities as follows: No.(s).....for Shares of the.....  
Bonds  
Shares of....., to be exchanged to.....Shares  
Bonds.....Bonds  
of the.....Shares of....., which, unless bearer  
Bonds

securities transferable by delivery, are to be issued in the name of the transferee hereinafter designated, and has also received such powers of attorney, and such assignments of the securities received by it as aforesaid and of the securities for which the same are to be exchanged as are required by the rules of the Stock Clearing Corporation. The securities received by the Stock Clearing Corporation will be presented by it for exchange as aforesaid and upon receipt by it of the securities into which the same are to be exchanged and the presentation and surrender to it of this instrument, the latter securities with the powers of attorney and assignments for the transfer thereof will be delivered to....., herein designated as the transferee, or, if this receipt has been properly endorsed, then to the person specified in said endorsement or to the holder hereof if the endorsement is in blank. Title to this receipt is transferable with the same effect as in the case of a negotiable instrument. Dated..... Stock Clearing Corporation by..... Assistant Manager.

(XIIIe) The face of the Stock Clearing Corporation temporary exchange receipt reads:

Stock Clearing Corporation hereby certifies that it has received securities as follows: No.(s).....for.....Rights  
Shares of the  
Bonds

Shares  
 .....Bonds of.....and.....  
 Dollars (\$).....) to be exchanged for.....  
 Shares ..... Shares  
 Bonds of the.....Bonds of.....,  
 which, unless bearer securities transferable by delivery, are to be issued in  
 the name of the transferee hereinafter designated, and has also received  
 such powers of attorney and such assignments of the securities received  
 by it as aforesaid and of the securities for which the same are to be  
 exchanged as are required by the rules of the Stock Clearing Corporation.  
 The securities and money received by the Stock Clearing Corporation will  
 be presented by it for exchange as aforesaid and upon receipt by it of the  
 securities into which the same are to be exchanged and the presentation  
 and surrender to it of this instrument, the securities with powers of attorney  
 and assignments, for the transfer thereof will be delivered to.....  
 .....herein designated as the transferee, or if this receipt  
 has been properly endorsed, then to the person specified in said endorsement  
 or to the holder hereof if the endorsement is in blank. Title to this receipt  
 is transferable with the same effect as in the case of a negotiable instrument.  
 Dated..... Stock Clearing Corporation by.....  
 ....., Assistant Manager.

## CHAPTER XIV

### Money and Loan Clearance and Settlement

(XIVa) The assignment on the back of the Stock Clearing Corporation contingent credit and debit lists reads as follows:

I (We) hereby pledge and assign to the Stock Clearing Corporation the securities mentioned in the list on the reverse side hereof, the numbers of which securities are entered on my (our) proper books of record, as and when received by me (us), to secure payment to the Stock Clearing Corporation of any and all amounts due or that may become due from me (us) to said Stock Clearing Corporation on this day's transactions by the Stock Clearing Corporation for my (our) account and I (we) do hereby agree that all of said securities so pledged shall be delivered to the Stock Clearing Corporation at 2:45 P.M. this day or on its previous demand unless my (our) debit balance with the Stock Clearing Corporation on the entire day's transactions has previously been settled or otherwise secured to the Stock Clearing Corporation's satisfaction, it being understood, however, that I (we) may substitute for said securities or any of them the proceeds thereof or other securities of equal value. I (We) agree in respect to all securities so pledged that the Stock Clearing Corporation shall have the right in the event of my (our) failure to pay any amount due by me (us) to said Stock Clearing Corporation upon the day's transactions as and when required by the rules of the said Stock Clearing Corporation to sell the whole or any part thereof on the New York Stock Exchange or any other available market or at public auction or by private sale and without notice to me (us). If the sale is made on the New York Stock Exchange

or the New York Curb Market Exchange or any other exchange or if the sale is at public auction, the Stock Clearing Corporation may purchase for its own account the securities sold. The proceeds of sale shall be applied by the Stock Clearing Corporation to my (our) debit balance and I (we) shall remain liable to the Stock Clearing Corporation for any deficiency.

.....Firm Signature.

Witness: .....

(XIVb) The longest "when issued" settlement ever conducted by the Stock Clearing Corporation occurred over a period of 16 months in the securities of the Missouri, Kansas and Texas Railway, whose reorganization was delayed by the Interstate Commerce Commission. Trading in the M. K. & T. securities "when issued" began on the Stock Exchange December 1, 1921, and did not terminate until April 5, 1923, when the definitive certificates were available for delivery. During this long interval the Stock Clearing Corporation conducted in the "when issued" contracts 9 markings to the market and 25 intermediate clearances altogether.

(XIVc) The Annual Report of the President of the New York Stock Exchange for 1929-30 (p. 112) contains the following table relating to obviation of banking accommodation by the Stock Clearing Corporation:

| Calendar<br>Year | Total Value<br>All Contracts<br>(millions of \$) | Funds Actually<br>Required<br>(millions of \$) | Funds<br>Obviated<br>(millions of \$) | %<br>Obviation |
|------------------|--------------------------------------------------|------------------------------------------------|---------------------------------------|----------------|
| 1921.....        | 15,940                                           | 4,206                                          | 11,633                                | 73.0%          |
| 1922.....        | 22,430                                           | 5,710                                          | 16,719                                | 74.5           |
| 1923.....        | 20,932                                           | 5,239                                          | 15,692                                | 75.0           |
| 1924.....        | 25,143                                           | 5,119                                          | 20,024                                | 79.6           |
| 1925.....        | 42,368                                           | 7,218                                          | 35,149                                | 82.9           |
| 1926.....        | 47,962                                           | 7,952                                          | 40,010                                | 83.4           |
| 1927.....        | 59,814                                           | 9,365                                          | 50,449                                | 84.3           |
| 1928.....        | 97,485                                           | 14,553                                         | 82,932                                | 85.1           |
| 1929.....        | 123,312                                          | 22,531                                         | 100,780                               | 81.7           |

The great actual and percentage increase in this obviation of bank funds is attributable not only to the expanding volume of business on the Stock Exchange during the years noted, but also to the widening scope of money clearance services performed by the Stock Clearing Corporation.

(XIVd) The Annual Report of the President of the New York Stock Exchange for 1929-30 (p. 112) contains the following table relating to the obviation by the Stock Clearing Corporation in the number of checks drawn in settlement of the business of Stock Exchange members:

|           | Items Theoretically Requiring Checks | Number of Checks Actually Required | Number of Checks Obviated | % Obviation |
|-----------|--------------------------------------|------------------------------------|---------------------------|-------------|
| 1921..... | 658,454                              | 54,609                             | 603,845                   | 91.7%       |
| 1922..... | 1,008,513                            | 59,250                             | 949,263                   | 94.1        |
| 1923..... | 1,433,538                            | 58,683                             | 1,374,855                 | 95.9        |
| 1924..... | 2,185,368                            | 57,952                             | 2,127,416                 | 97.3        |
| 1925..... | 2,745,502                            | 59,793                             | 2,685,709                 | 97.8        |
| 1926..... | 2,470,759                            | 56,826                             | 2,413,933                 | 97.7        |
| 1927..... | 2,945,780                            | 58,914                             | 2,886,866                 | 98.0        |
| 1928..... | 3,722,518                            | 72,147                             | 3,650,371                 | 98.0        |
| 1929..... | 4,242,130                            | 91,646                             | 4,150,484                 | 97.8        |

## CHAPTER XV

## The Commission House

(XVa) The ceaseless tendency in America to perfect labor-saving devices has at length directed its attention to the broker's stock board. Recently a mechanical board operated by electricity has been perfected, and in the course of time the board boy's occupation may become as lost as Othello's. The new mechanical quotation boards can be operated even at distances from a central station, and thus the new device may succeed not merely in supplementing but even in rivalling the existing stock ticker system.

(XVb) The broker's ability to loan or pledge securities carried in his customers' marginal accounts, even after the customers' consent has been obtained, has long been considerably restricted by the ethics of the brokerage business. Here again custom and precedent have gradually crystallized into specific regulations in the Stock Exchange Constitution (Rules, Chapter XII):

**Customers' securities.**

SEC. 2. The improper use of a customer's securities is inconsistent with just and equitable principles of trade.

**Agreements for use of securities.**

SEC. 4. An agreement between a member and a customer, authorizing the member to pledge securities, either alone or with other securities carried for the account of the customer, either for the amount due thereon or for a greater amount, or to lend such securities, does not justify the member in pledging or loaning more of such securities than is fair and reasonable in view of the indebtedness of said customer to said member.

**Agreements for use of securities.**

SEC. 5. No form of general agreement between a member and a customer shall warrant the member in using securities carried for the customer for delivery on sales made by the member for his own account, or for any account in which the firm of said member or any general or special partner therein is directly or indirectly interested.

(XVc) For a great many years it was the custom for Stock Exchange firms to report on their confirmations the names of the other



firms or members from whom or to whom their purchases or sales for customers were made.

In order to stamp out the sporadic but pernicious practice of non-member pseudo-brokerage firms who "bucketed" their customers' orders to purchase by not actually executing them at all, the legislature of New York State in 1913 enacted into State law this old Stock Exchange custom, in the following terms:

"The people of the State of New York, represented in senate and assembly, do enact as follows:

"Section 1. Article 86 of Chapter 88 of the laws of 1909, entitled 'An act providing for the punishment of crime' constituting chapter 40 of the consolidated laws is hereby amended by adding at the end thereof a new section, to be section 957, to read as follows:

"'Section 957. *Delivery to customers of memoranda of transactions by brokers*—A person engaged in the business of purchasing or selling as brokers stocks, bonds, and other evidences of debt of corporations, companies, or associations shall deliver to each customer on whose behalf a purchase or sale of such securities is made by him a statement or memorandum of such purchase or sale, a description of the securities purchased or sold, the name of the person, firm, or corporation from whom such securities were purchased or to which the same were sold, and the day, and the hours between which the transaction took place. A broker who refuses to deliver such statement or memorandum to a customer within 24 hours after a written demand therefor, or who delivers a statement or memorandum which is false in any material respect, is guilty of a misdemeanor, punishable by a fine of not more than \$500, or imprisonment for not more than one year, or both.'"

While this legislation has undoubtedly assisted in driving out of business the old-style bucketshop which actually executed no orders at all, unfortunately it has not proved a similar preventive of the modern bucketshop which buys legitimately enough for its customers but secretly sells out again practically at once; for this reason the modern bucketshop can often furnish its victims with legitimate confirmations, although it no longer is carrying the commitments to which they relate.

(XVd) Commissions charged on transactions effected on the Exchange by its members as brokers are subject to minimum rates as provided in the Constitution (Article XIX) as follows:

## ARTICLE XIX

### *Commissions*

**Obligation  
to charge  
and  
collect.**

\*SEC. 1. Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for account of others, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates

\* As amended May 13, 1926.

No rebate-  
ment or  
allowance  
for business  
procured.

in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a Rule adopted by the Governing Committee, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member of the Exchange or firm registered thereon.

\* SEC. 2. Commissions shall be as follows:

To non-  
members.

Joint  
accounts  
and non-  
member  
partners.

(a) *On business for parties not members of the Exchange, including joint account transactions in which a non-member is interested; and on transactions for partners not members of the Exchange:*

Stocks.

† ON STOCKS,

(except as to Inactive Stocks,  
as stated below):

| PRICE                                       | RATE PER SHARE     |
|---------------------------------------------|--------------------|
| Selling under 50¢                           | As mutually agreed |
| Selling at 50¢ and above, but under \$1     | Not less than 3¢   |
| Selling at \$1 and above, but under \$10    | Not less than 7½¢  |
| Selling at \$10 and above, but under \$25   | Not less than 12½¢ |
| Selling at \$25 and above, but under \$50   | Not less than 15¢  |
| Selling at \$50 and above, but under \$75   | Not less than 17½¢ |
| Selling at \$75 and above, but under \$100  | Not less than 20¢  |
| Selling at \$100 and above, but under \$200 | Not less than 25¢  |
| Selling at \$200 and above, but under \$250 | Not less than 30¢  |
| For each additional \$50 in price           | 5¢ additional      |

\$1.00  
minimum.

provided, however, that on every transaction which involves an amount of \$15 or more, the minimum commission shall be not less than \$1.00.

Inactive  
Stocks.

\*† ON INACTIVE STOCKS:

(as designated by the Committee of Arrangements):

| PRICE                      | RATE PER SHARE                                      |
|----------------------------|-----------------------------------------------------|
| Selling at less than \$100 | Not less than 20¢                                   |
| Selling at \$100 and above | { The same rates as<br>provided for other<br>stocks |

Bonds.

† ON BONDS:

Not less than \$2.50\$ per \$1,000 par value.

\* Effective June 10, 1926.

† See also Paragraph (d).

§ As amended October 29, 1925, and January 17, 1930.

## Rights.

## ON SUBSCRIPTION RIGHTS,

| PRICE                                    | RATE PER RIGHT     |
|------------------------------------------|--------------------|
| Selling under 50¢                        | As mutually agreed |
| Selling at 50¢ and above, but under \$1  | Not less than 3¢   |
| Selling at \$1 and above, but under \$5  | Not less than 5¢   |
| Selling at \$5 and above, but under \$10 | Not less than 7½¢  |
| Selling at \$10 and above.               | Not less than 15¢  |

## To members.

(b) *On business for members of the Exchange when a principal is not given up:*

## Stocks cleared.

## \* ON STOCKS:

(except as to Inactive Stocks, as stated below):

| PRICE                                      | RATE PER SHARE     |
|--------------------------------------------|--------------------|
| Selling under 50¢                          | As mutually agreed |
| Selling at 50¢ and above, but under \$1    | Not less than ¾¢   |
| Selling at \$1 and above, but under \$10   | Not less than 1¾¢  |
| Selling at \$10 and above, but under \$125 | Not less than 3¾¢  |
| Selling at \$125 and above                 | Not less than 5¢   |

## Inactive Stocks.

## \*† ON INACTIVE STOCKS:

(as designated by the Committee of Arrangements):

Not less than 8¢ per share.

## Bonds cleared.

## † ON BONDS:

Not less than \$1.25§ per \$1,000 par value.

## Rights cleared.

## ON SUBSCRIPTION RIGHTS:

| PRICE                                    | RATE PER RIGHT     |
|------------------------------------------|--------------------|
| Selling under 50¢                        | As mutually agreed |
| Selling at 50¢ and above, but under \$1  | Not less than ¾¢   |
| Selling at \$1 and above, but under \$5  | Not less than 1¼¢  |
| Selling at \$5 and above, but under \$10 | Not less than 1¾¢  |
| Selling at \$10 and above                | Not less than 3¾¢  |

## To members.

(c) *On business for members of the Exchange when a principal is given up:*

## Stocks not cleared.

## † ON STOCKS:

(except as to Inactive Stocks, as stated below):

| PRICE                                      | RATE PER SHARE     |
|--------------------------------------------|--------------------|
| Selling under 50¢                          | As mutually agreed |
| Selling at 50¢ and above, but under \$1    | Not less than ½¢   |
| Selling at \$1 and above, but under \$10   | Not less than 1¼¢  |
| Selling at \$10 and above, but under \$125 | Not less than 2½¢  |
| Selling at \$125 and above                 | Not less than 3¢   |

\* Effective June 10, 1926.

† See also Paragraph (d).

§ As amended October 29, 1925, and January 17, 1930.

Odd lots  
of stock  
not cleared.

Except that when the amount dealt in is less than 100 shares of stock the commission shall be not less than 1¢ per share on stocks selling below \$10 per share and 2¢ per share on stocks selling at \$10 per share and over.

Inactive  
Stocks not  
cleared.

\*† ON INACTIVE STOCKS:

(as designated by the Committee of Arrangements):

Not less than 4¢ per share.

Bonds not  
cleared.

† ON BONDS:

Not less than 75¢ cents per \$1,000 par value.

Rights not  
cleared.

ON SUBSCRIPTION RIGHTS:

| PRICE                                    | RATE PER RIGHT     |
|------------------------------------------|--------------------|
| Selling under 50¢                        | As mutually agreed |
| Selling at 50¢ and above, but under \$1  | Not less than ½¢   |
| Selling at \$1 and above, but under \$5  | Not less than ¾¢   |
| Selling at \$5 and above, but under \$10 | Not less than 1¼¢  |
| Selling at \$10 and above                | Not less than 2½¢  |

Exceptions  
to above  
rates.

‡(d) *On Obligations of the United States, Porto Rico, Philippine Islands, and States, Territories and Municipalities therein; Bonds or Notes having five years or less to run; Securities which, pursuant to call or otherwise, are to be redeemed within twelve months:*

Such rates to members or non-members as may be mutually agreed upon; provided, however, that the Committee on Quotations and Commissions may determine special rates on any or all of the above-mentioned securities, reporting the same to the Governing Committee.\*\*

Original  
issues.

SEC. 3. If a member of the Exchange, or firm registered thereon engages in transactions in which the member or firm is acting as a dealer in securities of original issue, the rates of commission prescribed in this Article shall not apply to such transactions if not made on the Exchange; provided, however, that such transactions shall be subject to such regulations as the Committee on Quotations and Commissions may from time to time prescribe.

Proposed  
violation.

SEC. 4. No member shall make a proposition for the transaction of business at less than the minimum rates of commission prescribed in this Article.

\* As amended June 10, 1926.

† See also Paragraph (d).

§ As amended October 29, 1925, June 28, 1928, and January 17, 1930.

‡ As amended December 16, 1926.

\*\* See note 1 on page 124.

(XVe) "There is a tendency on the part of the public to consider Wall Street and the New York Stock Exchange as one and the same thing. This is an error arising from their location. We have taken

pains to ascertain what proportion of the business transacted on the Exchange is furnished by New York City. The only reliable sources of information are the books of the commission houses. An investigation was made of the transactions on the Exchange for a given day, when the sales were 1,500,000 shares. The returns showed that on that day 52 per cent of the total transactions on the Exchange apparently originated in New York City, and 48 per cent in other localities." (Hughes Commission Report, 1909.)

## CHAPTER XVI

### The Administration of the Stock Exchange

(XVIa) Stock corporations have always been denied membership, not only in the New York Stock Exchange, but also in the Stock Exchange of London and the Paris Bourse. In the German-speaking countries, incorporated banks are permitted to engage in business on the exchange floor; it should, however, be noted that membership in the Berliner Borse or the Wiener Borse does not mean the same thing as in the exchanges of the English-speaking countries.

The prohibition against incorporated members has been due partly to the particular evolution of financial methods in this country, and partly to fundamental conceptions of the proper status and functions of the stock exchange. Undoubtedly it has been felt that the limited liability of corporations (as contrasted with the unlimited liability of individuals and partnerships) in cases of insolvency, would prove a hindrance to free market dealings, and perhaps an incentive to over-risky business methods. There is also the feeling in both England and this country that it is better both for the stock market and the money market to have stock brokerage organized as a specialized business separate and distinct from commercial banking. This attitude, from the American standpoint, can find adequate justification from the example of the Berlin market, whose commission business has been largely swallowed up by a few powerful incorporated banking institutions. In proportion as this development has occurred there, the Berlin broker has degenerated into a mere taker and handler of orders from these few great banks on the Borse floor.

This evolution in Berlin has resulted there in an actual "money trust," and prevented the development of a "free and open" market of the type maintained by the stock exchanges of New York and London.

(XVIb) Since membership in the New York Stock Exchange is limited, a membership possesses value like a property right. The same



thing is true among the 70 official Agents de Change in Paris. In the stock exchanges of London, Berlin, Amsterdam, Vienna, and other European centers where membership is not limited in this way, no such transferable value attaches to a membership. The price of a New York Stock Exchange "seat" varies according to supply and demand, and represents roughly a capitalization of its current and prospective earning power; through this latter fact it is a fair indication of the contemporary activity of the stock market. Despite the valuable real estate holdings, etc., of the New York Stock Exchange, the "asset value" of a seat is usually only a small proportion of its price.

The prices of New York Stock Exchange seats have risen tremendously during the last sixty years. Members who joined the Exchange in the 60's paid as little as \$500 for them. In the boom year of 1882 the price rose to \$32,500, but fell back to \$20,000 in the panic of 1884. In 1885, however, they rose to a record high price of \$34,000. In the panic of 1893 they collapsed to \$15,250 and fell further to \$14,000 in 1896. Thereafter, under active stock markets, the price rose to \$80,000 in 1901; in 1902 it reacted to \$60,000, in 1909 reached \$96,000, and in 1913 dropped to \$37,000.

After the war, the augmented activity on the Stock Exchange led to a huge rise in the price of its seats. From a low point of \$77,000 in 1921 the price passed through \$100,000 in 1924, touched \$150,000 in 1925, \$200,000 in 1927, and \$600,000 in 1929. During 1922-28, the average number of seats annually transferred was slightly in excess of 85 (see Annual Report of the President, 1928-29, p. 98).

(XVIc) Concerning the legal bearing of an expulsion of a member from the Exchange, John G. Milburn, counsel for the New York Stock Exchange, testified before the Committee on Banking and Currency of the United States Senate as follows:

"What then is the remedy of the member who has been tried and expelled? He may bring a suit in court, claiming that he has been illegally expelled. He can have all the proceedings before the board of governors produced in court. . . .

"On the trial of his suit there is produced in court all the proceedings before the board of governors, including the testimony taken and any documentary evidence, and the settled law is that to sustain the action of the governors it must appear, first, that the written charges alleged a specific violation of a rule; second, that the member had a hearing; third, that there was evidence to sustain the determination of the board of governors; and fourth, that the board of governors acted in good faith. These are the requirements formulated in

numerous decisions of the courts, including the highest court of the State. If it were found that any one of these requirements had not been observed, the expulsion would be held to be illegal and a restoration to membership would follow. . . .

"There have been numerous cases of this kind during all the years past, and the board of governors has been sustained in every case. That is a very remarkable record of ability, fair play and justice." (Regulation of the Stock Exchange, p. 350.)

(XVI<sub>d</sub>) The single instance where the action of the Governing Committee has been in any important degree modified by the courts occurred in 1882 in the Hutchinson case. At that time seats on the Stock Exchange were nothing like as valuable as today, being worth only a few thousand dollars, and their status as a property right was not legally established. In consequence, when the Governing Committee expelled Hutchinson from the Stock Exchange his seat was declared confiscated by way of fine. But the courts, although completely upholding the main action of expulsion, declared that a Stock Exchange seat constituted a property right, and therefore upon its owner's expulsion from the Exchange did not escheat to the Exchange.

(XVI<sub>e</sub>) The following excerpts from "Delivery of Securities," an official pamphlet issued by the Committee on Securities of the New York Stock Exchange (June 1, 1929) give a general idea of the delivery rules and practices in vogue in the New York Stock Exchange system.

## New York Stock Exchange

### COMMITTEE ON SECURITIES

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The Committee on Securities has adopted the following Rules, Regulations and Requirements:

**1. Certificates of Stock, Voting Trust Certificates, Certificates of Deposit for Stock and similar Certificates, to be a delivery must comply with the following Rules for Delivery:**

1. Certificates delivered in settlement of contracts shall be for the exact amount of the trading unit or for lesser amounts aggregating the trading unit, except as herein otherwise provided.

2. A contract in an odd lot shall be settled by the delivery of a certificate for the exact amount of the odd lot or certificates for lesser amounts aggregating the amount of the odd lot.

3. When more than one trading unit is to be delivered, certificates may be tendered in lots of one or more trading units and must be accepted and paid for as delivered, without affecting the right of the receiver to buy in the undelivered portion as provided in Chapter IV of the rules adopted by the Governing Committee.

4. A certificate must be accompanied by a proper assignment, executed either on the certificate itself or on a separate paper, in which latter case there must be an assignment for each certificate which must comply with the requirements of Rule 5. Each assignment must be guaranteed as required in Rule 22.

5. A separate assignment must contain provision for the irrevocable appointment of an attorney, with power of substitution, and a full description of the certificate, i.e., name of company, issue, certificate number, amount (the latter written in words and numerals). The entire description of the certificate must be in the same writing.

6. Any alteration or correction in an assignment or a power of substitution must be accompanied by an explanation on the original instrument signed by the person executing the assignment or power of substitution.

7. When an assignment has been filled in with the name of an individual or firm as attorney, a power of substitution must be executed.

8. The signature to an assignment or power of substitution must be technically correct, i.e., it must correspond with the name as written upon the certificate in every particular without alteration or enlargement or any change whatever.

9. A certificate in the name of a corporation or an institution, or in a name with official designation, is a delivery only when the statement "Proper papers for transfer filed by assignor" is placed on the assignment and signed by the transfer agent.

10. A certificate assigned by a Married Woman is a delivery only during the closing of transfer books, when a joint assignment and acknowledgment by husband and wife is necessary.

*(Note:—The foregoing rule is deemed necessary inasmuch as the laws of various jurisdictions do not vest absolute control of personal property in married women.)*

11. A certificate in the name of an Unmarried Woman with the prefix "Miss" is a delivery without acknowledgment, when signed "Miss."

12. A certificate in the name of a Widow or an Unmarried Woman without the prefix "Miss," is a delivery only when the assignment is properly acknowledged.

13. A certificate with an assignment or power of substitution executed by an Insolvent is a delivery only during the closing of transfer books, when such a certificate held by others than the insolvent must be accompanied by an affidavit that the said certificate was held on a date prior to the insolvency.

14. A certificate with an assignment or a power of substitution executed by a firm that has ceased to exist is a delivery only during the closing of the transfer books provided the assignment or power of substitution is properly acknowledged or proven.

15. A certificate with an assignment or a power of substitution executed by a firm that has dissolved and is succeeded by one of the same name is a delivery when the new firm shall have signed the statement "Execution Guaranteed" under a date subsequent to the formation of the new firm.

16. A certificate with an assignment or a power of substitution executed by a deceased person, trustee, guardian, infant, executor, administrator, assignee, receiver in bankruptcy, agent, or attorney is not a delivery, except as provided in Rule 35.

17. A certificate with an inscription to indicate joint tenancy, or with a qualification, restriction or special designation, is not a delivery.

A certificate with an inscription to indicate tenancy in common, unless signed by all co-tenants, is not a delivery.

18. Each signature to an assignment or a power of substitution must be witnessed by an individual.

19. Where there are two or more signatures to an assignment, the witness must state definitely, in his own handwriting, which signature he witnesses.

20. A certificate with either the assignment or power of substitution witnessed by a deceased person is not a delivery.

21. An endorsement by a member or his firm of (or the signature as a witness by such a member of a signature to) an assignment or a power of substitution is a guarantee of its correctness.

22. An assignment of a certificate not in the name of a member or a member's firm must be either witnessed by a member or the correctness of the signature guaranteed by a member or a member's firm. Each power of substitution executed by a non-member as well as the assignment, must be so witnessed or guaranteed.

23. A certificate with an assignment or power of substitution executed or guaranteed by a member or member's firm not having an office in the vicinity of the Exchange, or witnessed by such a member, must be guaranteed by a member or firm having an office in the vicinity of the Exchange or the assignment and each power of substitution must be stamped by such a member or member's firm first delivering it, as follows:

"Delivered by....."

(Name of resident member or firm.)

24. A certificate with an assignment or power of substitution guaranteed by a member or his firm, suspended for insolvency, is not a delivery unless reguaranteed by a member in good standing or his firm.

25. The receiver of stock may demand delivery by transfer when the transfer books are open and must give ample time in which to make transfer. The party making delivery may demand payment for the same at the time of delivery to the transfer office. Any expense imposed by a Transfer Agent must be defrayed by the receiver.

26. The seller may make delivery by transfer when personal liability attaches to ownership, while the transfer books are open.

27. The assignment and each power of substitution on a certificate of a company whose transfer books are closed indefinitely for any reason, legal or otherwise, must be properly acknowledged.

28. A certificate of stock on which the name of a transferee has been filled in in error, may be made a delivery during the closing of the transfer books by ruling of the Committee on Securities. Necessary detailed information will be furnished on application to the Secretary of the Committee.

29. Acknowledgments, affidavits, or depositions must be executed before an officer having authority to take acknowledgments under the Laws of the State of New York and must bear the seal of the signing officer.

30. In the acknowledgment of an assignment or power of substitution executed by an individual, the signing officer must certify that he knows the person signing to be the person named in the certificate or in the power of substitution and that the signor acknowledged his signature.

31. In the acknowledgment of an assignment or power of substitution in the name of a firm, the signing officer must certify that he knows the person and knows him to be, or to have been on the date of execution, a



member of the firm, or authorized to sign for the firm, under a power of attorney filed with the New York Stock Exchange, and that he acknowledged that he executed the assignment or power of substitution as the act and deed of the firm.

32. In proving an assignment or power of substitution, the witness must make deposition that he knows the person who executed the assignment or power of substitution to be the person named in the certificate or assignment, and saw the signor execute the same. For assignments of certificates in the name of a firm, the witness must make deposition that he knows the party signing to have been at the date of execution, a member of the firm or authorized to sign for the firm, under a power of attorney filed with the New York Stock Exchange.

33. Any alteration or correction in an acknowledgment must be properly noted by the signing officer.

34. A certificate for stock called for redemption is only a delivery when specifically dealt in as such, unless the entire outstanding amount has been called for redemption.

35. A firm having as a general partner a member of the Exchange may authorize one or more employees to assign registered securities in the firm name and to guarantee assignments, with the same effect as if the name of the firm had been signed under like circumstances by one of the partners of the firm by executing and filing with the Committee on Securities, in form prescribed by said Committee, a separate Power of Attorney for each employee so authorized.

**II. The following Rules shall apply to Coupon Bonds, payable to Bearer, Registerable as to principal and Registered Bonds; Corporate Stock of Municipalities; Government Bonds; Certificates issued for Deposit of Bonds or in lieu thereof; and Notes, the term "bond" being used in each case as a matter of convenience:**

51. Transactions in Coupon Bonds payable to bearer may be settled by delivery of bonds in the denomination of \$1,000 or \$500 each, except that in the case of United States Coupon Bonds \$5,000 and \$10,000 pieces, when exchangeable for \$500 or \$1,000 bonds, may be delivered.

52. Coupon bonds payable to bearer, of the denomination of less than \$500, shall be classified as "small bonds" and of the denomination of more than \$1,000, as "large bonds" and are to be dealt in specifically as such, except as otherwise provided.

53. When more than one trading unit is to be delivered, bonds may be delivered in lots of one trading unit and must be accepted and paid for as delivered, without affecting the right of the receiver to buy in the undelivered portion as provided in Chapter IV of the Rules adopted by the Governing Committee.

This rule does not apply to bonds sold "Delayed Delivery" in which case the entire amount of the contract must be tendered, unless otherwise mutually agreed.

54. In deliveries of bonds expressed in foreign moneys, the equivalent of \$1,000 in the case of Sterling bonds shall be £200 and in the case of Guilder bonds shall be 2500 Guilders, and such other equivalents as may from time to time be fixed by the Committee.

55. Coupon bonds must have securely attached proper coupons, warrants, etc. of the same serial number as the bond. The money value of a coupon



missing from a bond which is not registerable or convertible may be substituted therefor with the consent of the Committee on Securities for each delivery.

56. Coupon bonds which can be registered as to principal to be a delivery must be registered to bearer or if the transfer books are closed, must be accompanied by a proper assignment for each bond, provided however, that when coupon bonds may be "registered for voting purposes only" and such registration does not affect the negotiability of the bonds, such bonds may be delivered with such registration noted thereon.

57. A Coupon bond issued to bearer having an endorsement thereon such as a definite name of a person, firm, corporation, association, etc., not properly pertaining thereto as a security, is not a delivery unless sold specifically as an "endorsed bond."

The foregoing also applies to endorsements upon coupons.

58. A Coupon bond bearing a statement that it has been deposited in accordance with a governmental bank or insurance requirement is not a delivery. If released, with such release acknowledged before an officer authorized to take acknowledgments, it may be sold as a "released endorsed bond."

59. A transaction in Registered bonds may be settled by delivery of bonds of the denomination of not less than \$500 and not exceeding \$10,000, accompanied by a proper assignment for each bond.

60. The rules as to assignments of stock certificates shall apply to assignments of registered bonds, except that in the case of United States Government bonds and City of New York corporate stock, special forms of assignment are required by the respective authorities. No "guarantee" of signature is required or permitted on assignments of United States Government bonds.

### **III. The following Rules shall govern the Reclamation or Return of securities delivered on Exchange Contracts:**

101. Reclamation for irregularity in a security, when such irregularity affects only its currency in the market, must be made within ten days from the day of delivery of the security.

102. A security with an irregularity having been delivered may be returned up to 2:15 o'clock P.M. to the party who delivered it, who must immediately give the party presenting it either the security in proper form for delivery, or pay the market price of the security and assume all liability for non-delivery.

103. Whenever title to a security is called in question or a security is reported to have been lost or stolen it may be returned until it reaches the party who introduced it into the market, unless in the opinion of the Committee on Securities in any particular case, there are equitable considerations why such reclamation should not be made.

104. A security delivered subsequent to publication of notice of its being called for redemption may be returned or reclaimed until it reaches the party who held it at the time of such publication, unless in the opinion of the Committee on Securities in any particular case, there are equitable considerations why such reclamation should not be made.

This rule does not apply where an entire issue has been called for redemption or where securities called for redemption are dealt in specifically as such.

**IV. Interest and Dividends:**

151. When a claim is made for a dividend, rights or interest after transfer books have closed, the party in whose name the security stands may require from the claimant presentation of the certificate, a written statement that he was the holder of the security at the time of the closing of the books, a guarantee against any future demand for the same and the privilege to record on the certificate evidence of the payment by Cash or Due-Bill.

152. In all transactions involving the payment of interest, where the amount of such interest equals or exceeds five mills, it shall be considered as one cent, fractions of a cent less than five mills shall be disregarded. This rule shall apply to loaned and borrowed securities, interest on bonds, transfers of accounts and all other transactions.

153. Bonds dealt in "And Interest" delivered on dates on which interest is due and payable, shall be without the coupon due on such date.

**V. Due-Bills:**

201. A security delivered after the closing of transfer books for dividend, interest, or rights must be accompanied by a Due-Bill therefor whenever required by the Committee on Securities.

202. When, by direction of the Committee on Securities, a security is not quoted ex-dividend, ex-rights or ex-interest on the date the transfer books close therefor, the Due-Bill accompanying the security must be signed by the party in whose name the security stands.

203. A Due-Bill signed by a non-member must be guaranteed by a member or a member's firm in the same manner as required in the case of an assignment of stock and must be redeemed by the member or firm guaranteeing the Due-Bill.

204. Unless otherwise directed by the Committee on Securities, Due-Bills must be redeemed on the date of the payment of the dividend or interest, or in the case of rights on the settlement day for contracts in rights at the office of the member guaranteeing them located in the vicinity of the Exchange.

205. Due-Bills must be in such form as prescribed by the Committee on Securities.

**VI. Trading in Rights to Subscribe and Delivery of Warrants therefor must comply with the following Rules:**

251. "Rights to Subscribe" pertaining to securities dealt in on the Exchange, when admitted to dealings by the Committee on Securities, shall be traded in on the basis of one right accruing on each share of issued stock, except as herein otherwise provided.

252. When rights to subscribe are offered to holders of more than one class of securities, the Committee on Securities shall, in each case, determine the basis upon which transactions in the rights shall be made.

253. Transactions in rights admitted to dealings by the Committee on Securities shall be "When Issued," or otherwise, as directed by the Committee.

254. Transactions in rights on the final day for subscriptions shall be for "Cash." When the final day is a half-holiday, transactions on the preceding business day as well as on the final day shall be for "Cash." Dealings in rights on the final day shall cease at 1:30 o'clock P.M. (11:00

o'clock A.M. on half-holidays) unless otherwise directed by the Committee on Securities.

255. Contracts in rights may be enforced in the same manner as contracts in listed securities can be enforced under the provisions of Chapter IV of the rules adopted by the Governing Committee, except that on the final subscription date notice of intention to close a contract and the order to the Secretary to make such closing shall be delivered at or before 1:00 o'clock P.M. (10:30 o'clock A.M. on half-holidays) but such contracts shall not be closed before 1:05 o'clock P.M. (11:05 o'clock A.M. on half-holidays).

256. Except as herein otherwise provided, the rules for delivery of Certificates of Stock, where applicable, must be complied with in respect to warrants for rights.

257. The unit of trading in rights shall be 100 rights, except as otherwise directed by the Committee on Securities in any particular case.

258. Warrants delivered in settlement of contracts in rights shall be for the exact amount of the trading unit, or for lesser amounts aggregating the trading unit, unless otherwise agreed.

259. A contract for less than one trading unit shall be settled by delivery of a warrant for the exact amount contracted for or warrants for lesser amounts, aggregating the amount of the contract.

260. A warrant with an assignment executed by a Married Woman, Widow, or Unmarried Woman, is a delivery without notarial acknowledgment.

261. A warrant with an assignment executed by a trustee, guardian, executor, administrator, assignee, receiver in bankruptcy, or for a corporation, is not a delivery unless passed by the Committee on Securities.

262. A warrant with an assignment executed by a deceased person, infant, agent, attorney or a firm that has ceased to exist is not a delivery, except as provided in Rule 35.

263. Rights to Subscribe represented by warrants issued with or attached to listed securities, when admitted to dealings upon the Exchange by the Committee on Securities shall be dealt in as prescribed by the Committee in each particular case.

(XVI<sup>f</sup>) The following excerpts from Chapter IV of the Stock Exchange Constitution and Rules bear especially on closing of defaulted contracts:

SEC. 2. A contract in listed securities which has not been fulfilled according to the terms thereof may be officially closed by the Secretary, or by a member of the Committee of Arrangements, or by a person designated by the Committee of Arrangements, as provided in these rules.

The order to close such contract shall be delivered to the Secretary and the notice of intention to make such a closing must be delivered at the registered address of the member or firm in default; the order to close and the notice of intention to close shall be delivered at or before 2:30 P.M. on any day, but such contract shall not be closed before 2:35 o'clock P.M.

These regulations are supplemented by Rule 32 on the Stock Clearing Corporation By-laws and Rules.

(XVIg) The following is the text of the questionnaire form:

## New York Stock Exchange

### QUESTIONNAIRE FOR REGISTERED MEMBER FIRMS

**1. Total Bank Balances.**

Enter separately, amount of contribution to Clearing Fund of Stock Clearing Corporation, and deposits with Trust Companies to guarantee Cotton Contracts, etc.

**2. Total Money Borrowed, and Total Value of Collateral.**

Enter separately, accounts carried for your firm by other banking or brokerage houses, showing Debit and Credit money balances and value of securities both Long and Short.

State Ledger Balances in the following accounts:

Stock Borrowed,  
Stock Loaned,  
Failed to Deliver,  
Failed to Receive.

**3. Market Value of Negotiable Securities in Box and Transfer Books.**

Classify as follows:

Listed on New York Stock Exchange.

Market value over \$5 per share.

Market value under \$5 per share.

Not listed on New York Stock Exchange.

Market value over \$5 per share.

Market value under \$5 per share.

(Note)—Do not include the value of any securities in "Safe Keeping," nor the value of any securities carried as "long" if paid for in full by customers.

**4. Customers Accounts.** (All personal accounts other than members of the firm.)

(a) Total Ledger DEBIT BALANCES in Customers Accounts.

Classify as follows:

I—Secured (State value of securities).

II—Partly secured (State value of securities).

III—Unsecured.

(b) Total Ledger CREDIT BALANCES in Customers Accounts.

Classify as follows:

I—Against market value of short sales of securities.  
(State value of these short securities.)

II—Customers' credits as margin on open contracts in grain, cotton and other commodities. (State equity and deficit with these contracts figured at the market.)

III—Free Credit Balances.

(Note)—Do not include in answers to Question 4 the value of any securities in "Safe Keeping" nor the value of any securities carried as "long" if paid for in full by customers.

**5. Partners Accounts (including Capital Accounts.)**

Total Debit Balances and Total Credit Balances, also Total Value of Long Securities and Total Value of Short Securities in the following accounts:

- (a) Partners individual accounts.
- (b) Firm investments and trading accounts.
- (c) Underwritings and syndicate participation accounts.
- (d) Capital accounts.

**6. Profit and Loss Accounts.**

Surplus and Undivided Profits, including balances in Income and Expense accounts (Commission, Interest, Expenses, etc.) which will eventually be closed by journalizing to a Profit and Loss Account.

(Note)—This question may be answered by giving one net amount, specifying debit or credit.

**7. Other Accounts.**

State details (Ledger Balances and value of securities) of any accounts which have not been included in one of the answers to the above questions, entering each account separately. These accounts will include Exchange Seats, Office Furniture and other Fixed Assets, if carried on the books, Revenue Stamp Account, Dividend Account, etc.

**8. What practice is followed by your firm in complying with that part of Chapter XII, Section 4, of the Rules adopted by the Governing Committee pursuant to the Constitution, which declares that—**

“An agreement between a member and a customer \* \* \* does not justify the member in pledging or loaning more of such securities than is fair and reasonable in view of the indebtedness of said customer to said member.”

**9. Contingent Liabilities.**

Give brief description, in memorandum form, of any Contingent Liabilities of the firm, that are **not included in a ledger account.**

Items of this nature may include:—

“When Issued” Contracts.

(Total commitments of Customers.)

(Total commitments of Firm and Partners.)

Accommodation Endorsements.

Endorsements of Puts and Calls.

Rediscounted Notes.

Participation in any proposition subject to future demands.

**10. Partners Accounts in other offices.**

Have any general or special partners of your firm individually or collectively, any security or commodity accounts or commitments carried by other banking or brokerage houses, which are not reflected on your books?

If so, state Debit and Credit Balances, Value of Securities long and short, and Equity or Deficit in open commodity contracts.



(XVIh) The following provisions of the Stock Exchange Constitution (Rules, Chapter XV) cover periodic examination of securities held in safekeeping by Stock Exchange firms:

SEC. 2. Members of the Exchange and firms registered thereon carrying margin accounts for customers shall, as of the date of their answer to each questionnaire, cause to be made a complete audit of their accounts and assets, including securities held for safekeeping, in accordance with such regulations as shall be prescribed by the Committee on Business Conduct, and shall file with said Committee a statement to the effect that such audit has been made and whether it is in accord with the answers to the questionnaire. Such statement shall, in the case of each member of the Exchange not a member of a registered firm, be signed by such member of the Exchange, and in the case of each registered firm shall be signed by each member of such firm unless, for good cause shown, the signature of one or more members is waived by the Committee on Business Conduct. Such statement shall in all cases be attested by the auditors, and the original report of the audit, signed by the auditors, shall be retained as part of the books and records of the member or firm.

SEC. 3. Each member of the Exchange and firm registered thereon, not carrying margin accounts for customers, shall, at least once a year and whenever called upon so to do by the Committee on Business Conduct, report to said Committee whether such member or firm holds securities for safekeeping. Each of such members or firms holding securities for safekeeping shall, at least once in each year, file with the Committee on Business Conduct a statement that all securities held for safekeeping have been checked and found to be intact, which statement shall also show in what manner the verification of the securities has been made and the date thereof.

(XVIi) The Annual Report of the President of the New York Stock Exchange for 1929-30 (p. 110) contains the following percentage statistics of insolvencies since 1900 of New York Stock Exchange members, national banks, American banking institutions of all kinds, and American commercial firms:

| Year      | N. Y. S. E.<br>Members<br>% | All American<br>Banks<br>% | National<br>Banks<br>% | Commercial<br>Houses<br>% |
|-----------|-----------------------------|----------------------------|------------------------|---------------------------|
| 1900..... | 1.09                        | 0.57                       | 0.13                   | 0.92                      |
| 1901..... | 1.18                        | 0.64                       | 0.21                   | 0.90                      |
| 1902..... | 0.27                        | 0.51                       | 0.08                   | 0.93                      |
| 1903..... | 0.90                        | 0.88                       | 0.26                   | 0.94                      |
| 1904..... | 0.54                        | 0.67                       | 0.41                   | 0.92                      |
| 1905..... | 0.27                        | 0.78                       | 0.35                   | 0.85                      |
| 1906..... | 0.27                        | 0.32                       | 0.09                   | 0.77                      |
| 1907..... | 0.72                        | 0.67                       | 0.18                   | 0.82                      |
| 1908..... | 0.81                        | 0.84                       | 0.28                   | 1.08                      |
| 1909..... | 0.18                        | 0.36                       | 0.11                   | 0.80                      |
| 1910..... | 0.54                        | 0.52                       | 0.08                   | 0.80                      |
| 1911..... | 0.45                        | 0.44                       | 0.06                   | 0.81                      |
| 1912..... | 0.27                        | 0.31                       | 0.08                   | 0.98                      |
| 1913..... | 0.09                        | 0.46                       | 0.16                   | 0.99                      |
| 1914..... | 0.90                        | 0.79                       | 0.20                   | 1.10                      |
| 1915..... | 0.09                        | 0.49                       | 0.26                   | 1.32                      |

| Year      | N. Y. S. E.<br>Members<br>% | All American<br>Banks<br>% | National<br>Banks<br>% | Commercial<br>Houses<br>% |
|-----------|-----------------------------|----------------------------|------------------------|---------------------------|
| 1916..... | 0.00                        | 0.18                       | 0.10                   | 0.99                      |
| 1917..... | 0.36                        | 0.15                       | 0.06                   | 0.80                      |
| 1918..... | 0.54                        | 0.07                       | 0.02                   | 0.58                      |
| 1919..... | 0.27                        | 0.17                       | 0.02                   | 0.38                      |
| 1920..... | 0.45                        | 0.39                       | 0.08                   | 0.49                      |
| 1921..... | 0.72                        | 1.31                       | 0.49                   | 1.02                      |
| 1922..... | 0.81                        | 0.91                       | 0.35                   | 1.19                      |
| 1923..... | 0.45                        | 1.91                       | 0.93                   | 0.94                      |
| 1924..... | 0.36                        | 2.08                       | 1.48                   | 1.01                      |
| 1925..... | 0.09                        | 1.60                       | 1.36                   | 1.05                      |
| 1926..... | 0.00                        | 2.16                       | 1.25                   | 1.00                      |
| 1927..... | 0.09                        | 1.47                       | 1.38                   | 1.07                      |
| 1928..... | 0.09                        | 1.42                       | 0.91                   | 1.08                      |
| 1929..... | 0.16                        | 1.72                       | 0.87                   | 1.04                      |

(XVIj) "We have been strongly urged to recommend that the Exchange be incorporated in order to bring it more completely under the authority and supervision of the State and the process of the courts. Under existing conditions, being a voluntary organization, it has almost unlimited power over the conduct of its members, and it can subject them to instant discipline for wrongdoing, which it could not exercise in a summary manner if it were an incorporated body. We think that such power residing in a properly chosen committee is distinctly advantageous. The submission of such questions to the courts would involve delays and technical obstacles which would impair discipline without securing any greater amount of substantial justice. While this committee is not exactly in accord on this point, no member is yet prepared to advocate the incorporation of the Exchange and a majority of us advise against it, upon the ground that the advantages to be gained by incorporation may be accomplished by rules of the Exchange and by statutes aimed directly at the evils which need correction." (Hughes Report [see Van Antwerp, p. 427].)

(XVIk) After reviewing the abortive German attempts to regulate security speculation by legislation, Ellis T. Powell in "The Evolution of the Money Market" (p. 611) goes on to state that conversely, the absence of government control is one of the reasons for the predominance of London, as well as for the vast business that has concentrated in Wall Street; that on the Continent, there is sometimes municipal supervision of the Bourses—as in Belgium, or Imperial control—as in Austria; that in Holland, a theoretical government control amounts in practice almost to non-interference, while in Paris the Agents de Change are practically government officials; that the free, non-govern-

ment-controlled Stock Exchange might almost be described as a characteristic Anglo-Saxon institution, and that the task of incessant care and vigilance in the management of elusive economic forces is too huge and too subtle for statutory mandate to encompass. He quotes the Stock Exchange Commission of 1877 as follows: "Any attempt to reduce these (Stock Exchange) rules to the limits of the ordinary law of the land, or to abolish all checks and safeguards not to be found in that law, would, in our opinion, be detrimental to the honest and efficient conduct of business . . . the existing body of rules and regulations have been formed with much care, and are the result of long experience and the vigilant attention of a body of persons intimately acquainted with the needs and exigencies of the community for whom they have legislated."

He goes on to state (p. 612-13), "Corporate regulation, such as the Stock Exchange species, is dependent largely for its application upon the *esprit de corps* of a professional body. It is much more psychological in operation and sanction than the clumsier mandates and prohibitions of a public statute, backed merely by physical force. A Government might propose a system of ethics for the Stock Exchange, and enact it as a statute, but it could not procure its acceptance and observation. Psychological influence and the mysterious energy which we call *esprit de corps* can penetrate where statutory and mechanical pressure would be easily excluded. That is why the greatest religions have depended on the psychological sanction. Economic reform must depend largely on the employment of the same subtle and pervasive force."

## CHAPTER XVII

### The Stock Exchange and American Business

(XVIIa) "Stimulated by the urge for funds to finance the vast production program of the United States during the World War, the number of shareholders in the country's business enterprises has,\* it is estimated, grown from about two million to more than seventeen million; and out of increasing incomes these investors have continued to pour their savings into the stream of credit."—Report of the Committee on Recent Economic Changes, of the President's Conference on Unemployment (Herbert Hoover, Chairman), 1929, p. xii.

(XVIIb) In his address "The Stock Exchange and American Agriculture," delivered in Omaha, October 17, 1928, Mr. E. H. H.

Simmons, then President of the New York Stock Exchange, declared:

" . . . stock exchanges, by reason of their ability to distribute securities among investors, have in the past been able to direct an almost constant flow of capital into American commercial and industrial companies. But the stock exchanges have not been to the same extent able to perform a similar function for agriculture, because of the fact that there are practically no such agricultural securities. . . .

" . . . the gradual development of cooperative marketing in this country may sooner or later take the form of stock corporations, and if it does, the way lies open through our established stock exchanges to direct capital into agriculture just as in the past it has been directed into commerce and manufacturing. I have always felt myself that some form of share financing for agriculture, if it could be soundly devised, might in a financial way prove of real benefit. The farmer, as I see it, does not need new creditors, but rather new financial partners. In consequence, the farmer's financial salvation would seem rather to consist in the issuance of shares of some sort than in the continued issuance of mortgage and other bonds, under the burden of which he already suffers. The man who can invent a feasible way to enable our farmers as a class to obtain additional capital inexpensively from new share partners will, in my opinion, have performed a most valuable service for agriculture, by opening to agriculture an immediate access through the stock exchanges to the savings of the entire American people."

## CHAPTER XVIII

### The Stock Exchange as an International Market

(XVIIIa) This peculiar character of London security quotations arises largely from the way the "jobber system" operates on the London Stock Exchange. In that Exchange, a broker desirous of purchasing or selling securities for a customer does not deal viva voce with his fellow members as on the New York Stock Exchange. Instead he approaches the "jobber" or dealer in the particular security and requests the current bid and offer for the issue, without stating whether he is a buyer or a seller. The jobber proceeds to quote him the bid and offer (say, 50-50½), and after subsequent higgling may quote them closer (say, 50¾-50¾). If satisfactory to the broker, he then tells the jobber whether he wishes to buy or sell, and how much. The jobber is obliged to take stock at his bid or furnish it at his offer. The jobber's bid and offer are considered more public information than the price of an actual sale or purchase, and for this reason are quoted in preference to such sale or purchase prices. Such a custom on the London Stock Exchange is also justified by the enormous number of relatively inactive issues listed there, for which bids

and offers can almost always be furnished, but in which actual purchases and sales occur only intermittently.

(XVIIIb) "Negotiable securities which are quoted upon the exchanges rank next to banking credits as a medium of exchange because they are more readily convertible into money or credits than any specific commodity. Their value in this respect was recognized at least a century ago in the London market. It was declared by Thornton, in 1807, that stocks, by being at all times a salable and ready-made article, are, to a certain degree, held by persons in London on the same principle as bills, and serve, therefore, in some measure, like bills, if we consider these as a discountable article, to spare the use of bank notes. Such securities partake of the exchangeable character of money because they are not themselves specific commodities of limited consumption, but are titles to the earnings of corporations or pledges for periodical payments of sums of money in the form of dividends or interest. They come nearer than any other article to performing the function of money, in commanding all commodities, because they are desired for their power to earn money, rather than for their power to satisfy any special want." (Charles A. Conant, *Principles of Money and Banking*.)

(XVIIIc) The *Compagnie des Agents de Change* has for centuries held the monopoly in France of acting as brokers in bullion and bills of exchange, and in furnishing public quotations for them. The development of French banks, however, made this privilege largely useless and without significance to the official stock brokers. Accordingly, they gradually waived this right. As a result, there is today an official foreign exchange market in the Bourse where official foreign exchange quotations are made, yet actually *Agents de Change* take little or no part in it and buyers and sellers are mainly representatives of the large Paris banks and credit institutions.

In the Berliner Borse, a room is also set aside for foreign exchange trading and the establishment of official rates. Dealers in this market are mainly the representatives of the great Berlin banks and credit institutions, who in Berlin are permitted to make contracts directly on the Borse floor in securities as well. Although accompanied by certain official formalities, foreign exchange dealings on the Berliner Borse really represent only the market between Berlin banks.

A proposal to inaugurate dealings in foreign exchange on the New York Stock Exchange was made in 1920-21, and arose from



the contemporary wide post-war fluctuations in foreign exchange rates. In behalf of the proposal it was urged that a centralization of the New York foreign exchange market on the New York Stock Exchange would make for uniform and more stable rates, and would make it possible to standardize market practice and enforce compliance with them in the interest of the public. But it was found that the existing organization of the New York money market would not coincide with such a plan, and that further difficulties arose in standardizing the financial instruments in which the prospective dealings were to occur. The result was that after some discussion, interest in the proposal waned and finally died out.

(XVIIIId) "There is one point I think I am justified in referring to, and that is the influence of the exchange on the international money market. If we had no general market like the stock exchange, and no great mass of listed securities which are known abroad as well as at home, the movements in the international money market would be much more violent and acute than they now are. Today the ordinary merchant, or the manufacturer on a large scale, can go about his business serenely conscious that he will get his money at from 4 to 6 per cent at the outside, and he does not concern himself to see whether we are exporting gold or not. But if we had no general securities market by which we could borrow on securities in Europe and sell drafts to meet demands, you would have a most violent and convulsive movement of the foreign exchanges, which would react upon the whole money market. You would have large exports of gold, because there was no other way of meeting obligations or getting credits abroad. We have had, as you know, violent fluctuations, in fact, by reason of the defects in our currency system, but they would be multiplied many fold if we could not establish foreign credits. As you know, there is a class of persons who make it a business of seeking a profit of a small fraction of 1 per cent when securities are a little higher here than they are in Paris or a little lower in London than they are in New York. Their operations tend to keep uniform, comparatively uniform, the supply of credit and they influence the foreign exchange market, and thereby travel toward the same stabilizing tendency as short-selling and the general functions of the exchange itself." (Regulation of the Stock Exchange, p. 189, testimony of Charles A. Conant.)

(XVIIIId) "To close America's chief securities market, and thereby render its \$40,000,000,000 of listed securities almost non-negotiable,

was a momentous step. Not since 1873 had the Stock Exchange suspended except for a few hours. Even the panics of 1907 and 1893 had not halted its operations. Yet to have attempted to maintain trading in New York, and thus invite the tremendous selling orders in which the whole world with its billions of American securities would undoubtedly have participated, would have been sheer folly. On the other hand, it was almost equally important that the maximum amount of liquidation comparable with national safety should be permitted to run its course there, in order that the reopening of the New York market might be effected the more speedily and the more safely. The able manner in which the governing committee of the New York Stock Exchange rose to meet this difficult dilemma has been dramatically related by H. G. S. Noble, then president of the Exchange. A few minutes before the usual opening hour of 10 A.M. the governors voted by a large majority to close the Exchange until further notice. Subsequent events wholly confirmed the complete wisdom of this step. If, as has been so frequently asserted, the war was eventually won by the individual initiative of the American soldier, sailor and business executive, it is equally certain that our then debtor nation owed its avoidance of a panic to the ability of the governors of the Stock Exchange to meet on their own responsibility an unparalleled crisis with an expert knowledge of its possible consequences and of the exact minute at which to terminate dealings on the floor." (Brigham in the *Boston Evening Transcript*, Oct. 20, 1920.)

(XVIIIIf) During the war and post-war period, many prices marked "S 30" (seller thirty days) appeared on the tape and in the daily financial reports. Such transactions are usually assumed to be sales by European holders of our securities back to American purchasers, through the machinery of the Stock Exchange, for it usually requires a European seller thirty days to liquidate any securities in our markets, owing both to the fortnightly term settlement system in vogue on European stock exchanges and the time required to send the certificate across the Atlantic. These "seller 30" transactions in recent years on the New York Stock Exchange were the outward and manifest sign of the gradual lifting of the vast mortgage previously held by European investors on our leading railroad systems and industrial establishments.

(XVIIIIfg) The annual Report of the President of the New York Stock Exchange for 1929-30 (p. 81) summarized the issues listed upon it as of January 1, 1930, as follows:

## DOMESTIC AND FOREIGN LISTINGS

(As of January 1, 1930)

|                           | No. of<br>Issues | % to<br>Total<br>Issues | Market Value           | % to<br>Total<br>Value |
|---------------------------|------------------|-------------------------|------------------------|------------------------|
| Security                  |                  |                         |                        |                        |
| U. S. Gov't.....          | 65               | 2.29                    | \$13,247,914,036       | 11.87                  |
| Foreign Gov't.....        | 203              | 7.16                    | 15,945,538,473         | 14.29                  |
| U. S. Co. Bonds.....      | 1146             | 40.41                   | 15,955,983,362         | 14.30                  |
| Foreign Co. Bonds.....    | 129              | 4.55                    | 1,743,022,909          | 1.56                   |
| U. S. Co. Stocks.....     | 1261             | 44.46                   | 63,247,559,053         | 56.67                  |
| Foreign Co. Stocks.....   | 32               | 1.13                    | 1,460,319,078          | 1.31                   |
| <b>TOTAL.....</b>         | <b>2836</b>      | <b>100.00</b>           | <b>111,600,336,911</b> | <b>100.00</b>          |
| Total U. S. Issues.....   | 2472             | 87.17                   | 92,451,456,451         | 82.84                  |
| Total Foreign Issues..... | 364              | 12.83                   | 19,148,880,460         | 17.16                  |

(XVIIIh) The following table, compiled from the elaborate analysis and estimates of international payments made by Dr. Ray O. Hall (Assistant Chief, Finance and Investment Division, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce) shows the main items in our international trade balance since 1923 (000,000 omitted):

## PRINCIPAL ITEMS IN U. S. INTERNATIONAL TRADE BALANCE

(Items marked "+" = credit account, and "-" = debit account. Source—"The Balance of International Payments of the United States in 1929," by Ray Hall, p. 66)

| COMMODITIES (ADJUSTED)                              | 1923   | 1924   | 1925   | 1926   | 1927   | 1928   | 1929   |
|-----------------------------------------------------|--------|--------|--------|--------|--------|--------|--------|
| Exports.....                                        | +4,368 | +4,834 | +5,177 | +5,044 | +5,091 | +5,333 | +5,490 |
| Imports.....                                        | -4,162 | -3,952 | -4,544 | -4,766 | -4,508 | -4,483 | -4,756 |
| Visible Trade Balance.....                          | + 206  | + 882  | + 633  | + 278  | + 583  | + 850  | + 734  |
| INVISIBLE ITEMS                                     |        |        |        |        |        |        |        |
| Freights.....                                       | - 83   | - 64   | - 84   | - 95   | - 66   | - 80   | -115   |
| Net Tourists Expenses.....                          | -280   | -373   | -410   | -406   | -444   | -552   | -565   |
| Interest on Foreign Funds in the United States..... | -180   | -192   | -229   | -268   | -281   | -359   | -414   |
| Interest on U. S. Funds Abroad.....                 | +594   | +635   | +689   | +740   | +800   | +893   | +976   |
| Interest on War Debt.....                           | +167   | +160   | +160   | +160   | +160   | +157   | +145   |
| Principal of War Debt.....                          | + 92   | + 23   | + 26   | + 35   | + 46   | + 50   | + 62   |
| Gov't. Transactions (net)....                       | - 66   | - 53   | - 61   | - 49   | - 29   | - 57   | - 92   |
| Immigrant Remittances (net) .                       | -229   | -229   | -235   | -218   | -206   | -225   | -223   |
| Charities, etc.....                                 | - 70   | - 55   | - 50   | - 46   | - 49   | - 51   | - 49   |
| Misc. Items (net).....                              | + 57   | + 68   | + 74   | + 74   | + 74   | + 24   | + 25   |
| NEW PRIVATE LOANS, INVESTMENTS AND DEPOSITS         |        |        |        |        |        |        |        |
| U. S. Investments Abroad....                        | -210   | -744   | -753   | -687   | -853   | -1,196 | -782   |
| Foreign Investments in U. S..                       | +240   | + 11   | +193   | +147   | +158   | + 488  | +396   |
| Bank Credits.....                                   | + 3    | +216   | - 61   | +359   | .....  | - 226  | + 13   |
| Net Capital Movement.....                           | + 33   | -517   | -621   | -181   | -695   | - 934  | -373   |
| OTHER BALANCING ITEMS                               |        |        |        |        |        |        |        |
| Gold.....                                           | -295   | -216   | +102   | - 72   | +154   | + 272  | -120   |
| U. S. Paper Money.....                              | + 50   | - 20   | - 30   | .....  | .....  | .....  | .....  |
| Net Discrepancy.....                                | + 4    | - 49   | + 36   | + 48   | - 47   | + 12   | + 9    |

(XVIIIi) The comparative use of gold shipments, short banking credits and securities in balancing American international payments each year is illustrated in the following table (000,000 omitted):

## INTERNATIONAL SHIFTINGS OF FINANCIAL ITEMS

|           | Balances |        |            |
|-----------|----------|--------|------------|
|           | Gold     | Credit | Securities |
| 1923..... | -295     | + 3    | + 30       |
| 1924..... | -216     | +216   | -733       |
| 1925..... | +102     | - 61   | -560       |
| 1926..... | - 72     | +359   | -540       |
| 1927..... | +154     | .....  | -695       |
| 1928..... | +272     | -226   | -708       |
| 1929..... | -120     | + 13   | -386       |

(Minus gold items=net American gold imports, and plus gold items=net American gold exports. Plus credit items=net American short loans abroad, and minus credit items=net American short borrowings from abroad. Minus security items=net American excess of foreign security purchases over foreign investments here, and plus security items=net excess of foreign investments here over our investments abroad.)

(XVIIIj) "Japan passed through a severe crisis in 1901, and part of the year before, because of the barrenness of her stock market. She had been engaged in great enterprises, but the stimulus given her industrial interests did not prove immediately profitable. Her people had begun importing great quantities of foreign goods, including too many luxuries, and the result was that she had large debts to pay abroad. If she had had a good security market, these debts would have been settled by the transfer of securities; but having only a few securities, and those of doubtful value, to throw upon the London market, she was compelled to settle at a sacrifice the demands upon her for money. She was compelled to sell goods for any price that could be obtained. . . .

"France was saved from one of the greatest crises of history by the large holdings of securities among her people during the Franco-Prussian War. When Germany demanded an indemnity of five thousand millions of francs (\$1,000,000,000), it was in the belief that its payment would throw a paralysis upon French industry and enterprise which would prostrate them for a generation. But what happened? When the French Government appealed to the people, saying, 'We need five thousand millions of francs to pay off this indebtedness,' the whole matter was adjusted through the securities market, and in a few years the Bank of France resumed the payment of gold for its notes, Frenchmen subscribed liberally for the securities of the new loans to pay off Germany, and in order to obtain the necessary funds, they directed their broker to sell in London, Berlin, Vienna, Brussels and New York the old securities which they held. Five thousand million

francs were thus taken from the capital of France, but she was so rich that she was able to submit to it without disaster. She was rich because she had piled up these securities, with which she was able to part without suffering. . . .

"France, by the possession of a flexible stock exchange and a great mass of the securities negotiable upon such exchanges, was saved from the convulsion which must have prostrated her entire industrial system if it had been necessary for her to find money to discharge the demands of the conqueror." (Charles A. Conant, *Wall Street and the Country*.)

Even more convincing examples occurred during and after the Great War. Britain could not have financed the war in 1914-17 without her large holdings of foreign securities, particularly American. The avoidance of serious inflation in the United States has been largely due to our extensive security investments abroad. The restoration of sound currency and credit in one European nation after another was largely brought about through the sale of foreign securities in New York. It is also generally admitted that without extensive sales of her securities here, Germany would not have been able to pay her reparation accounts. The ultimate settlement of the war debts is also generally expected to take the specific form of selling foreign securities here.

(XVIIIk) The increasing rapprochement of the New York Stock Exchange with the older stock exchanges of Europe during recent years is illustrated by the several visits paid to the latter institutions by officers and representatives of the American organization. In 1926 the Economist of the New York Stock Exchange spent three months studying foreign stock exchange methods in London, Paris and Berlin, and President E. H. H. Simmons on the same occasion paid an official visit to the stock exchanges of London and Paris. In 1927 the special commission on listing foreign internal shares (consisting of Mr. J. M. B. Hoxsey, Mr. R. L. Redmond and the author) visited for purposes of study London, Paris, Amsterdam, Berlin, Milan, Rome, Vienna, and Brussels. In 1928 the President and the Economist of the Exchange visited London; in 1929 Paris, Amsterdam, and Berlin; and in 1930 Rome, Milan, and Zurich. These visits have resulted in the interchange of much information concerning securities and stock exchange operation of real value on both sides of the Atlantic. Meanwhile the New York Stock Exchange has been visited officially by the representatives of many European stock exchanges, and of many financial institutions in Europe, South America and Asia.



(XVIII) In his very thorough and stimulating book "The Evolution of the London Money Market," (London, 1915) Mr. E. T. Powell made an interesting plea for international cooperation in the security business. Citing the need for an authoritative international code applicable to all internationally negotiable securities, he quotes (p. 562) the address by Mr. H. D. Jencken before the London Institute of Bankers: "Of the importance of the question of establishing international rules regulating the rights and liabilities of the holders of negotiable securities, no doubt can be entertained. These negotiable instruments are the carriers of the accumulated capital of civilized races; the enormous total they represent is divided up among men of every grade, of every class of social life; by the millionaire bankers, the artisans or the peasants, wherever we travel we find these securities treasured up as the ultimate resources of families, the reserve to fall back upon in the hour of need. Proportionally, as international intercourse and commerce increase, the need becomes more urgent, that these securities should be based upon a uniform system of law and practice, universally recognized in Europe and in the transoceanic continents inhabited by Europeans."

Powell goes on to declare that if mediæval intellects could evolve and apply the Law Merchant, we should not today hesitate at international financial regulation, enacted and enforced by a cosmopolitan money power. He quotes the statement of Zangwell that "in the security necessary for international investments lies the prime hope of the world's peace." He goes on to declare that finance is in reality a mode of pacific assimilation which, spreading ceaselessly over the world, correlates all human activity, allays class struggles and pacifies clashes between nations. "Under financial inspiration," he asserts, "we think internationally."

Powell was especially interested in the ancient ideal represented by the Law Merchant as a code of international jurisprudence (p. 697). If, he argues, this code could have been applicable when transportation was slow and communication very difficult, its utility today would be a thousand times greater, and therefore its reattainment is all the more necessary. For this, he thinks, a cosmopolitan control would be necessary.



## REFERENCES FOR FURTHER STUDY

(Arranged According to Chapters of This Book)

(Students are herein briefly referred to the general bibliography following, for the full titles, etc., of indicated works.)

### Chapter I. The Evolution of Securities

Material upon the evolution of securities in America is scattered and specialized though profuse; as yet no single classic has been written covering adequately this whole field. Evans has traced the origin of preferred stock, and other writers of bonds. The full significance of common stock as a long-term investment was not generally realized until Mr. E. L. Smith's convincing study. Chamberlain (2nd ed.) is still a standard authority on bonds.

The best modern American studies of the financial structure of corporations are those of Jordan, Gerstenberg, Conyngton, Lyon, Lagerquist and Mead. Studies by Moody, Hadley, Meeker, Sumner, Adams (John, Jr.), Burgunder, Sullivan, Wood and Rollins are also useful. Stetson is valuable for the legal aspect.

Modern American securities manuals are primarily Moody's and Poor's. Good manuals on foreign securities by Kimber and Winkler are also available; in this regard, see the special bibliography by Rossi.

In the works of Henri Sée and Ehrenberg one can trace the evolution of European securities. Powell has done a masterly study respecting the evolution of securities in England; J. A. Hobson and Bisscop should also be consulted. Giffen is useful for mid-nineteenth century conditions, and Withers "Stocks and Shares" gives a very readable description of present-day British securities. Davies is more up-to-date and more technical. Parkinson is brief but practical. Sturgess on the British Companies Act is also pertinent to any real grasp of British securities.

### Chapter II. Organized Markets and Their Economic Functions

Material regarding the evolution of the New York financial markets will be found in the next chapter. For similar material on Boston (Mass.) see Martin; for London, see Powell and Bisscop. Other good British works are: Duguid, a semi-official and very readable history

of the London Stock Exchange, Francis' well-known *Chronicles*, and the recent study by Jenks. For continental markets, the German Sombart is a classic, and his compatriot Ehrenberg also very valuable. Sée is brief yet clear and vital. Hallam might also be consulted.

The effect of the Great War (1914-18) on the securities markets is described for New York, by Noble and in the "Agricultural Inquiry"; for London by Schwabe, Whyte and Withers, "The War and Lombard Street"; for Paris by Borbeau, Manchez, Bregard and Guyot; and for Berlin by Klebba and Kronenberger.

For a general survey of the leading modern financial markets, two German works should be mentioned—Stillich's "Die Borse und ihre Geschäfte" and Taeuber's "Die Borsen der Welt." T. E. Gregory's "Money Markets of the World" is useful in a supplementary way. Van Antwerp contains vital and readable descriptions of the stock exchanges of London, Paris, and Berlin. Gibson covers New York, London and Paris. Greenwood is also very useful and inclusive, but so detailed and encyclopedic as to become speedily out of date.

For the New York Stock Exchange, the best sources (apart from the present study) are Huebner, Dice, Van Antwerp, and Martin.

For the London Stock Exchange, its official annual "Rules and Regulations" should be studied. The clearest and best-arranged recent study is in French, by Decoudu. Poley and Gould is standard for its legal aspects. Hirst is brief yet deservedly popular. Ingall and Withers described pre-war conditions at more length. Branson is readable and useful. Spalding on the London money market should also be read in this connection.

For the Paris stock market, the rules are published in pamphlet form for the official market by the *Chambre Syndicale* of the *Compagnie des Agents de Change*, and for the *Coulisse* or *Curb* market by the *Syndicates* for term and for cash trading. Some of the best studies on the Paris securities market reflect the friction which before 1898 occurred between the official stockbrokers' monopoly and the free *Curb* market. Boissière is a semi-official volume sympathetic to the monopoly, while Vidal (better known in this country because Englished in the *National Monetary Commission Report*) reflects the *Coulisse* advocacy of freedom of markets. Parker is an American Ph.D. thesis available in English but rather lacking in financial background. Of recent works, Cavelier and Montarnal are the best.

Material on the Berliner Borse is also voluminous, especially during the long and controversial period of the Borse regulations of 1896-1909. Stillich is generally considered the outstanding study.

Schneider's pamphlet is modern, detailed and surprisingly comprehensive considering its brevity; the author's connection with the Borse administration makes it a semi-official publication. The official rules and regulations are issued by the Handelskammer in pamphlet form; Hartung's "Usancen" and Meyer's "Borsengesetz" are also standard works. Sayons' article of course reflects the French viewpoint.

Amsterdam's Stock Exchange has been much described, but usually in Dutch. The anniversary Gedenboek is a splendid historical study, and Ogtrop is also authoritative. The "Statuten en Reglementen der Vereeniging voor den Effectenhandel te Amsterdam" is available only in Dutch. In German, however, one can read Brenningkmeier and Stillich; in French, there is some very interesting and valuable information in *L'Illustration* for August, 1928. For other markets, consult the general bibliography under their respective nations.

The functional aspect of organized markets has been described elaborately in England by Lavington, Ellis, and J. A. Hobson; one should also consult on this score the references under Chapters IV and V following. Huebner in America was first to outline the economic functions of stock exchanges systematically. Conant is also helpful. Emery is the best authority on their speculative aspects. Simmons' addresses in San Francisco (1926), Chicago (1926), and Norfolk (1929), and Whitney's address in New York (1930), are also popular presentations of important phases.

Organized commodity markets have been considered mainly outside the scope of the present book, yet references to G. Huebner, Hubbard, and Boyle are of interest to students of stock exchanges.

### Chapter III. The Rise of the New York Stock Exchange

The early records of the New York stock market (1792-1817) are scanty and intermittent; one must piece together the story of these days from the New York Post or from old notebooks of contemporary stockbrokers. The archives of the Exchange itself really date from 1817. Hunt's Merchants' Magazine, which ran from 1839 through the Civil War, is useful only in a general way. The early history of the New York stock market was, however, accurately and delightfully surveyed in Stedman's classic history of the Exchange, which runs down to about 1900. (Would that another Stedman would appear to write an equally readable history of the Exchange from the latter date to the present!) Hill and Villard, more easily obtainable than Stedman, also cover this early period.

Interesting sidelights on the period to the close of the Civil War are furnished by numerous yet obscure authors and pamphleteers like



Train. Barrett is more substantial. Hamon's Manual is dated 1865. The biography of Jay Cooke by Oberholtzer gives in readable form an account of Civil War financing.

The active financial period of the late 60's and of the 70's is reflected in Medbury's excellent though curiously named study, while Adam's famous "Chapter of Erie" gives an idea of the evils in American corporate management which the development of Stock Exchange listing requirements ultimately checked. Eames reflects the period of the 80's and early 90's. Hemming's history was published in 1905. Lawson's "Frenzied Finance" is scarcely scientific history, but is worth reading for its historical importance.

The ensuing "Age of Big Business" is graphically described by Hendrick and Moody in the Yale Chronicles and also in modern biographies of the leading financiers of the day. The panic of 1907 is described by Noyes and explained by Meyer.

The so-called "trust-busting" era of 1908-14 devoted considerable attention to proposals for "regulating" the Stock Exchange, which have since subsided to merely an agrarian muttering. The Report of the Hughes Commission (in Van Antwerp and also in "Regulation of the Stock Exchange") is reasonable in tone, though occasionally inconclusive, and still a valuable document to study. Its Chairman, Horace White, also wrote several valuable articles upon its work. The Federal "Money Trust Investigation" which followed shortly after this New York State inquiry, was more violently biased and partisan; the extraordinary limitations placed upon witnesses called before it invalidates much of its value as an economic source. The same thing may in general be said of the report of the Committee, often called the "Pujo Report." The hearing on the bill S. 3895 entitled "Regulation of the Stock Exchange" was, on the other hand, a completely fair and open hearing, and is still the most valuable single source book for information concerning the pre-war Stock Exchange. The testimony of Messrs. White, Emery, Milburn, Noble, and Conant are of particular value, and also the memorable brief by counsel for the Exchange—a masterpiece of its kind. The experience of the Exchange at the outbreak of war in 1914 was ably dealt with by Noble's brief yet pithy volume. There is some material concerning the mechanics of Stock Exchange clearances and wire houses in the "Alleged Divulgence of the President's Note" hearings. In the "Agricultural inquiry" (1921) there is much valuable material, particularly from the money market angle, concerning the stock market during the war and during the boom and collapse of 1919-20. The "Stabilization hearings" (1926-29) also contain, particularly in Part

III, valuable original material on the call money market. On the same lines, the "La Follette resolution" hearings of 1928 are also enlightening. Whitney's address in Boston (1930) gives intimate details of the 1929 panic.

Meanwhile, material has been available from the Stock Exchange itself: Van Antwerp in 1914, Martin in 1919, and Meeker (1st ed.) in 1922. Annual Presidents' Reports have been issued since 1921-23. President Simmon's address "New York: Metropolis and Capital Market" sums up briefly over 130 years of consistent Stock Exchange evolution.

The corollary development in the New York banking field can most easily be followed in two centenary volumes—Lanier for the Farmers' Loan & Trust, and Brown for Brown Bros. & Co. Sprague's well-known study of pre-Reserve American banking is also fruitful reading.

#### Chapter IV. The Distribution of Securities

Emery was the first American economist to realize the full significance of speculative stock market distribution—witness his "Place of Speculation in the Theory of Distribution." The author went somewhat further into this important phase of stock market activity in the first edition of this work (1922), and in 1928 published a more elaborate statistical study concerning it in his pamphlet "Distribution of Securities through the Stock Market." The ratio of Exchange member collateral borrowings to total market value of listings, issued monthly by the Statistical Department of the Exchange since 1926, has also thrown fresh light on this subject (See Annual Presidents' Reports for and since 1927-28). President Simmons has in his addresses several times alluded to the practical significance of this distributory function of the Stock Exchange—see addresses in Pittsburgh (1928) and Atlanta (1929). For additional material on preliminary distribution, consult the pamphlet "The New York Curb Market," Galston on syndicates and Sturgis' original book on investment.

The appendices to this chapter give the New York Stock Exchange listing requirements in full. Consult also Pomroy testimony, pamphlet by W. D. Williams, and the Simmons' St. Louis address (1926). The study in listing foreign internal securities by Messrs. Hoxsey, Meeker, and Redmond contains some interesting and obscure material. The author's unpublished study "Some Notes on Investment Trusts" contains a summary of British experience with investment trusts in the past. Campbell's legal study on transfers, and the works on Blue Sky laws by Reed and Washburn, and also by Spring, provide useful background.

On American security frauds, consult the Simmons addresses, particularly those of Richmond in 1924, Chicago 1925, and Milwaukee 1925.

Apart from original listing documents obtainable at the respective foreign stock exchanges, for listing in London see "Rules and Regulations of the Stock Exchange"; for Paris, Desmaisons' recent able study; and for Berlin, the work of Jacobs, Laves, and Phillipp. British underwriting features are covered by Nash, Sturgiss, and Tobey.

### Chapter V. Dangers and Benefits of Stock Speculation

As stated in the text to this chapter, there is an enormous literature on the subject of speculation, and most of it possesses little value because little real effort is spent in clearly defining just what speculation is. As a result, most works on speculation beat around the bush, change their definition of speculation constantly, and arrive at no particular conclusion.

Respecting the theory of security speculation, the American economist Emery is clearest and most consistent; his early theoretical Columbia thesis "Speculation on the Stock and Produce Exchanges of the United States" was, as the author pointed out, definitely justified in practice by the German experience with anti-speculative laws, concerning which Emery's articles are classics. His view here is generally supported by Friend, Knipper, Plochmann, Pflieger, and others. Among the American economists, Brace, A. B. Clark, Stevens, Seligman, and particularly Conant have also made valuable contributions to the theory of speculation; the best British authorities here are Crump and Ellis, while among the Germans Cohn, Lexis, and Michaelis are most fruitful.

Recently, economists have been inclined to stress the vital relationship between speculation and risk-bearing; here Hawley, Haynes, and J. B. Clark foreshadowed the more recent and extensive work of Hardy—this latter is fundamental to any real grasp of the subject.

Respecting the relation between speculation and the Stock Exchange, the Hughes Commission Report is still fundamental; President Simmons has more recently affirmed the attitude of the Exchange in this regard in addresses in Portland (1926), Detroit (1927), and Manchester (1929), and so has President Whitney in Chicago (1930).

Much has been written on speculation by students of the so-called business cycle. The older school includes Burton's classic, Jones, and also the more journalistic work of Gibson and Noyes. The newer school is headed by Mitchell, but also includes Persons, Vance, Hicker-

nell, and many others. Here the President's "Conference on Unemployment" should be consulted. Dewey has defined speculation in its legal aspects. The practical money-making aspect of stock speculation is covered by Atwood, Browne, Dow, Fayant, Nelson, Seldon, Sexsmith, and Stafford.

### **Chapter VI. A Typical Investment Transaction**

Consult Norton and Goldman for the legal aspects of a brokerage transaction, and Todman for its accounting aspects. See also references to Chapter XV on the Commission House. Withers describes the technique of investment purchasing in London, while Paris procedure is covered fully by Cavelier and Montarnal; see also Paul Leroy-Beaulieu in *L'Economiste Français* for October 5, 1912.

### **Chapter VII. Credit Transactions in Securities**

Van Antwerp's chapter on short selling and Noble's 1914 testimony should be consulted; Huebner's "The Stock Market" is also valuable. Norton covers the legal aspects of the short sale.

Abroad short selling often occurs only in term as distinguished from cash trading, and its technique thus depends upon the features of the given term settlement system. Withers covers this for London, while Paris operations are described in Montarnal and Cavelier. Many special studies on this score have been published in Germany. Consult the term settlement references under Chapter XI on stock market loans.

### **Chapter VIII. The Floor Trader and the Specialist**

See the relevant parts of Van Antwerp (p. 285). The best study of the specialist's work is the unpublished address of Mr. E. T. Tefft alluded to in the footnotes of the text. On the significance of stock market taxation, consult Seligman and Carroll.

### **Chapter IX. The Odd-Lot Business**

Van Antwerp and the 1914 testimony of Noble (pp. 164-169) are useful. Unpublished addresses by Noble and Mellick also contain much information. Some odd-lot houses have published pamphlet brochures on their business.

### **Chapter X. The Bond Market**

There is of course a huge literature upon the American bond business in general, but surprisingly little valuable material concerning the bond market on the Stock Exchange. The student might to advantage consult the works of Chamberlain, Rollins, and Sumner.



### Chapter XI. The Security Collateral Loan Market

Consult Holdsworth, Langston, and Westerfield for general American banking practice, and for the functional aspect of different banking laws, Waldo F. Mitchells' small but significant study. As for the governmental inquiries and hearings, the call loan market played only an incidental part in the "Money Trust Investigation" and in "Regulation of the Stock Exchange." Of late years, however, security loans have been the chief source of governmental criticism of the stock market. Senate Document 262 contains a comprehensive description of call loans by the Federal Reserve Board. The inner history of call loans during and immediately after the war will be found in the able testimony of Governor Benjamin Strong in the "Agricultural Inquiry" (pp. 450-814), and subsequently in the "Stabilization" hearings (pp. 290, 316, 349, 421, 464, 519) and the subsequent 1928 hearings (pp. 12-21, 386). The latest hearings of this sort have been those upon the La Follette resolution, in which will be found the testimony of Professor Sprague (p. 31).

For descriptive material on the pre-war call loan market, the reader should consult the testimony of Turner and Griesel in the "Money Trust" hearings, and also Hollander, Milburn, White, and Norton. The unpublished address of W. W. Atterbury is also informative. Pratt and Huebner describe general post-war conditions. Griffiss' little study is very useful. The Stock Exchange attitude has been expressed by President Simmons in his addresses at St. Petersburg (1925), Cincinnati (1927), Chicago (1929), Manchester (1929), and Norfolk (1929). Lawrence's "Wall Street and Washington" is pugnacious yet realistic and detailed. Writers on the Federal Reserve system have usually side-stepped the question of call loans, either because they are not rediscountable or because they are so controversial; Burgess, however, is excellent as far as he goes. Anderson's 1921 study is illuminating in regard to functions of call loans during 1920.

Specific information concerning "Lombard" or other security collateral loans abroad is surprisingly difficult to obtain; it is omitted or minimized in most European works upon general banking. In respect to the latter, however, it is worth while reading for background Willis and Beckhart, Withers, Liesse, Patron, and the Reichsbank rechartering material.

Respecting term settlements, the only American material consists of Streit's pamphlet and the author's subsequent and extensive study. Term settlement loans in London are described by Butterworth; in France by Dufourmantelle; in Germany by Aschenbrenner, Schmidt,



Pohl, and Thorwalt; and in Amsterdam by Smith and the Committee report of the Vereeniging voor den Effectenhandel.

### Chapters XII, XIII and XIV. On Clearance and Settlement

American material includes report of the Stock Exchange Committee on clearing houses, Cannon, Noyes, Pratt, Richter, and Streit, as well as the official publications of the Stock Clearing Corporation. A complete account of stock exchange clearing systems in London, Berlin, and Paris is given in the author's study on term settlements. Todman is valuable on the accounting aspects of American security clearances, and Goldman on their legal aspects. H. H. Cohen gives a valuable brief account of the evolution of security clearance in New York.

There seems to be no complete account in print of the London Stock Exchange settlement operations, although Decoudu is informative. For the Paris Bourse, see Boissière. German material on the Liquidationskasse A. G. and the Bank des Berliner Kassen-Vereins includes the official publications of those institutions, and also informative articles by Beseler in Bank-Archiv. The Rheinisch-Westfälischer Kassen Verein's Geschäfts-Ordnung are interesting in their provisions for the depositing of registered securities.

### Chapter XV. The Commission House

Good general descriptions may be found in Van Antwerp, Pratt, Dice, and Huebner. Smitley's briefer studies are more practical. Todman is particularly inclusive from the accounting standpoint. Legal aspects are well covered by Goldman, and also by Glenn and Norton. *Commerce and Finance's* special number was devoted to wire houses; on this see also "Alleged Divulgence of the President's Note."

London stock brokerage is described in varying detail by Callaway and English, Cordingley, Day, Killik, Kennedy, and Lidington.

### Chapter XVI. The Administration of the Stock Exchange

In general, see Van Antwerp, Huebner, Struble, and official publications of the New York Stock Exchange. The legal aspects will be found in Dos Passos, Goldman, and in various briefs by counsel for the Exchange.

For critical discussion, consult Hughes Report and articles by White, Money Trust, Pujo Report, Regulation of the Stock Exchange, Noble, brief by counsel relicensing stockbrokers, and Annual Reports of the President.

Official or semi-official publications abroad upon the administration of foreign stock exchanges are: for England, Duguid; for France, Boissière; and for Germany, Schneider. Respecting governmental regulation of stock exchanges abroad, consult for England, the Royal Commission Report; for France, Boissière, Vidal, and Desmaisons; and for Germany, the Börsen-Enquête-Kommission, Arnum, Friend, Emery, Loeb, and Guyot.

### **Chapter XVII. The Stock Exchange and American Business**

Van Antwerp is especially useful here. Consult also Moulton, Wither's "Case for Capitalism," Spicer (London). The best single study on the subject is still Conant's "Wall Street and the Country." See also articles by Hall and Sager and various addresses and interviews of President Simmons.

### **Chapter XVIII. The Stock Exchange as an International Market**

A general description is in Van Antwerp and Pratt, and an account of the 1914 crisis in Noble. The theory and practice of foreign exchange is dealt with by Escher, York, Gonzales, and Jevons.

The classic theoretical exposition of international trade balances is by C. K. Hobson, although it relates largely to British trade. R. O. Hall's American statistics are fundamental, and discussions in "Recent Economic Changes" are practical and valuable. Consult also Lewis, Withers, Conant's 1914 testimony (p. 189), and Adams' "New Empire."

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